JOURNAL OF ACCOUNTANCY

FEBRUARY 2013

HOW TO

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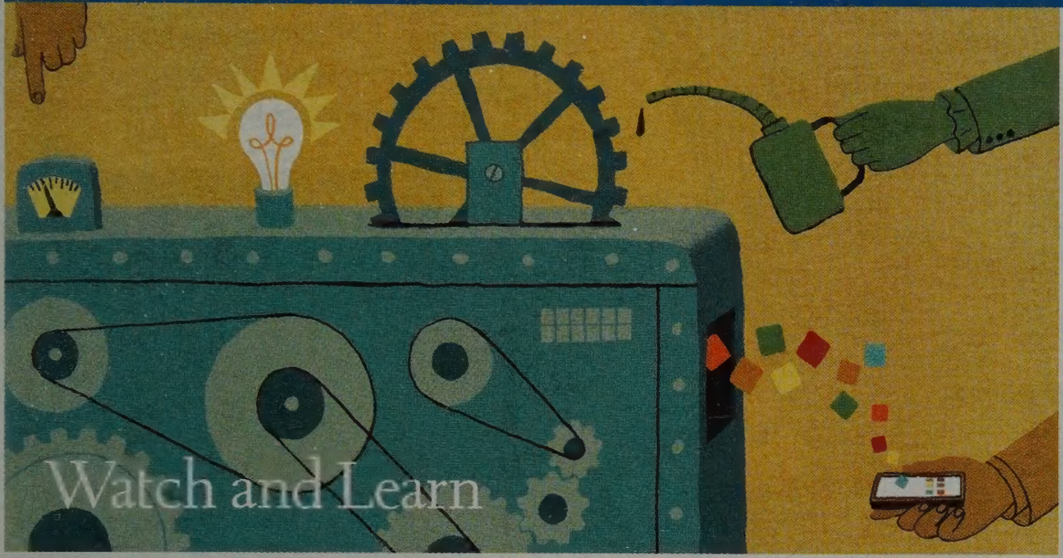

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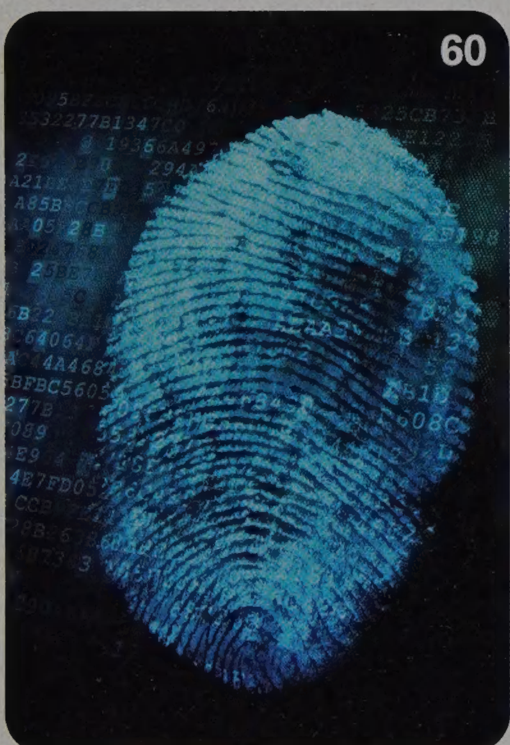

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How to Drive Partner Accountability and Unity page 32

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How to Do Business Abroad: A Rising Number of Small and Midsize Companies Go International page 40

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Tax Cliff Averted page 46

Paul Bonner is a senior editor for tax-related articles and items for the *JofA* and *The Tax Adviser*. He also is an adjunct instructor teaching news writing in the School of Journalism and Mass Communication at the University of North Carolina at Chapel Hill.

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■ **What Have IASB and FASB Convergence Efforts Achieved?** page 50

Paul Pacter, CPA, Ph.D., served as a member of the International Accounting Standards Board (IASB) from July 2010 through December 2012. Before joining the board, he served concurrently as the IASB's director of standards for small and medium-sized entities (SMEs), and director in the Global IFRS Office of Deloitte Touche Tohmatsu in Hong Kong. He was International Accounting Fellow at the International Accounting Standards Committee from 1996 to 2000, and he has served as executive director of the Financial Accounting Foundation.

■ **Stopping Tax Identity Theft: Practical Advice for CPAs and Clients** page 60

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News Digest

Visit journalofaccountancy.com for news updated daily, and to sign up for email news alerts on topics of your choice.

HIGHLIGHTS

PCAOB member Jay Hanson said that he struggles to see how the board would ever be able to create a mandatory audit firm rotation requirement for the U.S. public company auditors it regulates.

During a question-and-answer session at the AICPA Conference on Current SEC and PCAOB Developments in Washington in early December, Hanson said that many obstacles to mandatory audit firm rotation make its implementation unlikely. "I can't imagine that we'd go forward," he said.

In an interview after the Q&A session, Hanson elaborated on his comments. He said that to create a mandatory rotation requirement that would have a chance of being approved, the PCAOB would have to consider statistical evidence that firm tenure is linked to audit failures and deficiencies. The board also would have to complete an analysis showing that the benefits of mandatory firm rotation would outweigh the costs, he said.

"We've got all those things to do before we could meaningfully propose or adopt mandatory firm rotation," Hanson said. "I'm skeptical as to whether we'd ever get there with all those hurdles in front of us."

Hanson emphasized that the comments were his own and that he was not speaking on behalf of the other four members of the PCAOB, which would ultimately have to vote on the topic. His comments—and those of fellow board members—suggest that the discussion is far from over.

PCAOB Chairman James Doty said at the conference that it is important to examine ways to protect auditors' independence, "including by considering term limits."

(Continued on page 13)

AUDITING

The PCAOB is reminding auditors to maintain their professional skepticism when they conduct audits.

A staff audit practice alert issued by the PCAOB said the board has observed continued instances in which auditors did not appropriately apply professional skepticism.

Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in Audits*, is intended to assist audit firms in their application of professional skepticism in upcoming calendar year-end audits.

"Professional skepticism is an attitude that requires a questioning mind and a critical assessment of audit evidence," PCAOB Chief Auditor and Director of Professional Standards Martin Baumann said at the AICPA Conference on Current SEC and PCAOB Developments in Washington. "It is essential to the performance of every audit and for effective audits."

The practice alert is available at tinyurl.com/cr7p7fx.

A new International Auditing and Assurance Standards Board (IAASB) proposal would require auditors to read and consider information in certain documents that accompany audited financial statements.

If this additional information leads the auditor to identify a material inconsistency, or a misstatement in the audited financial statements, the auditor would be required to respond appropriately.

The ED, available at tinyurl.com/d4uydww, is called International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*.

Depending on the nature of a material inconsistency discovered, the auditor's responses could include:

- Requesting that management correct the other information, and making sure the correction is made.
- Reporting the matter to those charged with governance to get a correction made.
- Considering the reporting implications of the inconsistency.
- Withdrawing from the engagement, where possible under law.

A discovery that audited financial statements may be materially misstated could lead an auditor to report the inconsistencies in the auditor's report. If the discovery occurs after the date of the auditor's report, the auditor would be required to follow the guidance in ISA 560, *Subsequent Events*, regarding such discoveries.

The IAASB is an international body that develops auditing and assurance standards and guidance. It has set a due date of March 14 for comments on ISA 720 (Revised).

Auditors looking for guidance on the new clarified auditing standard about audits of group financial statements can turn to a new resource.

The new standard, AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, *Professional Standards*), took effect for audits of group financial statements beginning for calendar year 2012/fiscal year 2013 audits as part of the AICPA Auditing Standards Board's clarity project.

Nonauthoritative guidance regarding the implementation of AU-C Section 600 is available in 23 Technical Questions and Answers (TPAs) that are available in new TIS Section 8800, *Audits of Group Financial Statements and Work of Others*.

The TPAs, available at tinyurl.com/6kj2uku, are based on the questions and answers included in the Audit Risk Alert *Understanding the Responsibilities of Auditors for Audits of Group Financial Statements—2012*.

BUSINESS & INDUSTRY

■ Economic optimism, which started 2012 on an upswing, fell to a 12-month low, according to the *AICPA Business & Industry U.S. Economic Outlook Survey* for the fourth quarter.

A big reason for the gloomier mood: Washington.

"The overwhelming majority of comments this quarter focused on the fiscal cliff and government or politics," said the report, which polled CPAs who hold executive positions in companies across an array of industries. "Pessimists were most concerned about government policies and inability to get things done, particularly with the fiscal cliff, the results of the election and the level of government debt, deficits and spending."

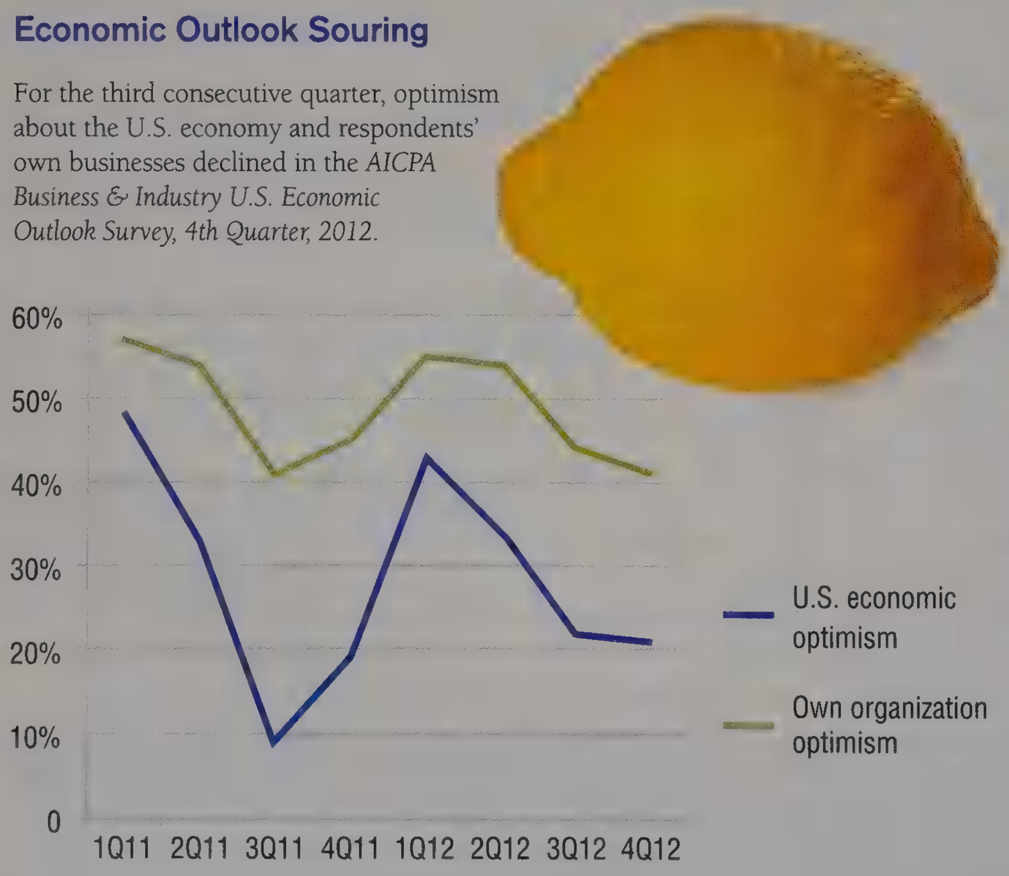
Just 21% of the 1,668 qualified respondents indicated that they were optimistic or very optimistic about the U.S. economy in the next 12 months, down from 22% in the previous quarter. During the same period, however, respondents who were once neutral became more pessimistic. Forty-nine percent of respondents were pessimistic about the next 12 months, up from 40% in the third-quarter survey.

Economic optimism is one of several indicators that make up the CPA Outlook Index, which fell to 59—the lowest point since the third quarter of 2011. A score of 50 or more is generally considered positive. But the index dipped as each of its components—economic optimism, organizational optimism, expansion plans, revenue, profits, employment, IT spending, other capital spending, and training and development—hit a 12-month low.

The survey is available at tinyurl.com/3px6u9l.

Economic Outlook Souring

For the third consecutive quarter, optimism about the U.S. economy and respondents' own businesses declined in the *AICPA Business & Industry U.S. Economic Outlook Survey, 4th Quarter, 2012*.



Source: *AICPA Business & Industry U.S. Economic Outlook Survey, 4th Quarter, 2012*, **tinyurl.com/93a9s7n**.

COMPILATION AND REVIEW

■ The AICPA Accounting and Review Services Committee (ARSC) exposed for public comment proposed Statements on Standards for Accounting and Review Services (SSARS) as part of its clarity project.

ARSC separated the proposals in an attempt to make the clarified standards easier to use, understand, and implement. The proposed SSARS *Review of Financial Statements* addresses areas that are applicable to a basic review engagement. The proposed SSARS *Review of Financial Statements—Special Considerations* addresses areas that are encountered less frequently.

The proposed SSARSs would supersede paragraphs 1.07 to 1.08 and 3.01 to 3.73 of SSARS No. 19, *Compilation and Review Engagements* (see AICPA, *Professional Standards*, AR Sec. 60 and AR Sec. 90).

Comments on the ED, which is available at tinyurl.com/b2v5jjm, are due April 26.

FINANCIAL REPORTING

■ The cumulative amount of revenue entities recognize under a new converged standard should not be subject to a significant revenue reversal or downward adjustment under guidance tentatively approved by FASB and the International Accounting Standards Board (IASB).

The boards met to discuss elements of the revenue recognition standard, which is scheduled to be released in the first half of 2013.

The boards' tentative decisions were posted on FASB's website. They decided that an entity would meet the objective of the constraint if the entity possesses experience or evidence supporting its assessment that the cumulative amount of revenue recognized should not be subject to a significant revenue reversal.

A reversal is a downward adjustment that might arise from subsequent changes

in the estimate of the amount of variable consideration to which the entity is entitled. The standard would require an entity to reassess this objective as changing facts and circumstances come to light.

The assessment the entity would perform would be qualitative.

More information, including additional tentative decisions on consumer credit risk and licenses for intellectual property with respect to revenue recognition, is available at tinyurl.com/b4y78xu.

■ A new proposal would narrow the definition of financial instruments in FASB's recently implemented standard on disclosures about offsetting assets and liabilities.

FASB issued a Proposed Accounting Standards Update (ASU), *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures About Offsetting Assets and Liabilities*. Comments from stakeholders were due Dec. 21. The proposal is available at tinyurl.com/cv7zfcu.

Disclosures will apply to derivatives, repurchase agreements, and reverse purchase agreements, as well as securities borrowing and securities lending transactions that are offset in accordance with FASB criteria or subject to a master netting arrangement or similar agreement.

In December 2011, FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures About Offsetting Assets and Liabilities* (available at tinyurl.com/ckchc5f). The standard was the result of a joint FASB project with the IASB and was created to improve transparency and comparability between U.S. GAAP and IFRS.

The standard requires enhanced disclosures about financial instruments and derivative instruments that are either offset on the statement of financial position or subject to an enforceable master netting arrangement or a similar agreement.

After the standard was finalized, companies realized that many contracts have standard commercial provisions that would equate to a master netting arrangement. As a result, FASB decided to narrow the definition of financial instruments in ASU No. 2011-11 to prevent unnecessary compliance costs for situations where disclosures would provide minimal value to users.

■ FASB directed its staff to prepare an ED of an ASU on presentation of items reclassified out of accumulated other comprehensive income (OCI), according to the board's website.

During a meeting, the board discussed feedback from stakeholders on the ED issued in August, *Comprehensive Income (Topic 220): Presentation of Items Reclassified Out of Accumulated Other Comprehensive Income*.

FASB made key decisions, which will become effective only after a formal written vote by the board on the ASU:

1. The ASU will require an entity to provide enhanced disclosures to present, separately by component, reclassifications out of accumulated OCI.
2. If U.S. GAAP requires items to be reclassified to net income in their entirety, the ASU would require the entity to disclose the effect of reclassification on the respective line items of net income. For items that U.S. GAAP does not require to be reclassified to net income in their entirety, the ASU would require an entity to provide a cross-reference to other disclosures currently required under U.S. GAAP for those items.

When the information contained in Items 1 and 2 is presented in notes to financial statements, the ASU will not require the entity to present the information in a tabular format as long as all the required information is in a single location.

The ASU would allow the required information in Item 2 to be presented in the notes or parenthetically on the face of the financial statements, as long as all the information is presented in one place. Entities will have the option of voluntarily providing duplicate information in the notes and on the face of the financial statements.

If approved, the ASU will be effective

HIGHLIGHTS

(Continued from page 11)

The PCAOB on Aug. 16, 2011, issued a concept release asking for comments on whether mandatory audit firm rotation would improve auditor independence, objectivity, and professional skepticism. The release said that at the time, the average audit firm tenure for the top 100 U.S. public companies was 28 years. The PCAOB was concerned that auditors' objectivity could be diminished if they were afraid their work jeopardized those long-standing, lucrative relationships between their firms and the companies they audit.

A few months later, the European Commission issued mandatory audit firm recommendations that have been the subject of debate in the European Parliament. The PCAOB has held numerous public hearings on mandatory rotation where the board has heard many alternatives that could improve objectivity and independence.

The AICPA has written a comment letter opposing mandatory audit firm rotation, saying rotation would have costly and unintended consequences and may hinder audit quality. (The letter is available at **tinyurl.com/cl45dnf**.) The PCAOB has received more than 650 letters on the subject; an Ernst & Young study released in January 2012 showed that more than 90% of the letters posted at that time opposed mandatory rotation.

During a hearing in March, some members of the U.S. House Subcommittee on Capital Markets and Government Sponsored Enterprises grilled Doty on audit firm rotation, saying the board needed to consider the costs and benefits. Doty said the board would not implement a mandatory audit firm rotation requirement without such a study.

"We have numerous obstacles," Hanson said.

for reporting periods beginning after Dec. 15, 2012, for public entities and for reporting periods beginning after Dec. 15, 2013, for nonpublic entities.

More information is available at tinyurl.com/bunw7ly.

■ Going-concern financial reporting in the United States appears headed for new requirements after FASB decided to adopt a new model in a project that still has several issues to be decided before the scheduled release of an ED in the first half of this year.

The model under discussion would put the focus of financial reporting requirements for management's assessment of going concern on the likelihood of an entity's potential inability to meet its obligations within a reasonable amount of time as they come due, according to a summary of board decisions posted on FASB's website. The summary is available at tinyurl.com/at9avwk.

Management would assess the entity's potential inability to continue as a going concern, and the need for related disclosures, each reporting period.

The triggering circumstance for management to begin disclosing an entity's financial difficulties comes when it is "near more likely than not" that the entity may be unable to meet its obligations in the ordinary course of business within a reasonable amount of time from the balance sheet date.

■ Limited changes to IFRS standards for classification and measurement of financial instruments were proposed in an International Accounting Standards Board (IASB) ED.

The proposal would change IFRS 9, *Financial Instruments*, as part of a larger convergence project with FASB as the boards reform accounting for financial instruments, which has seen considerable changes in recent years.

The IASB published new classification and measurement requirements for financial assets in 2009 and financial liabilities in 2010. But in January, the board decided to consider limited amendments to clarify a narrow range of application questions and reduce differences with FASB's developing model. The IASB also wanted to take into account the interaction between the classification and measurement of financial assets and accounting for insurance contract liabilities.

Changes were kept to a minimum because the IASB considers IFRS 9 to be fundamentally sound, and because some entities have already adopted or prepared to adopt the standard as previously published.

The amendments are consistent with the business-model-driven classification structure in IFRS 9. The ED proposes introducing a fair value through other comprehensive income measurement category for debt instruments that would be based on an entity's business model.

FASB is scheduled to release an ED on classification and measurement of financial instruments in the first half of 2013. In addition, the boards are scheduled to release separate EDs on impairment of financial instruments before the end of the first quarter of this year.

Convergence is expected to be limited in the impairment EDs because FASB decided to develop a "Current Expected Credit Loss" model that is different from the IASB's "three-bucket" model for credit risk impairment (see "FASB's Developing Model 'Totally' Changes Impairment Concept," tinyurl.com/dx35jto).

The ED is available at tinyurl.com/bwbgz9s.

FRAUD

■ Roughly 3,000 tips on alleged wrongdoing were passed on to the SEC in the first full fiscal year of a new whistleblower program.

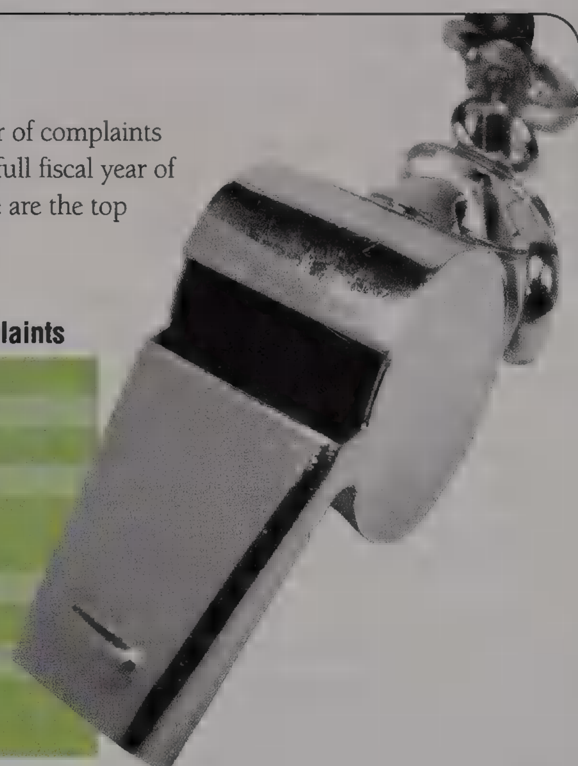
Tips came from all 50 states and 49 countries, according to an annual report on the program for the fiscal year that ended in September. The program was created to comply with a requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, P.L. 111-203.

Allegations about corporate disclosures and financials, which represented 18.2% of submissions to the SEC, were the most common category of complaints from whistleblowers, followed closely by offering fraud (15.5%) and manipulation (15.2%).

State of Whistleblowing

California led U.S. states in the number of complaints submitted in fiscal year 2012, the first full fiscal year of the SEC's whistleblower program. Here are the top states in complaints submitted:

	State	No. of complaints
1.	California	435
2.	New York	246
3.	Florida	202
4.	Texas	159
5.	(tie) New Jersey	102
	(tie) Washington	102
7.	Illinois	99
8.	Pennsylvania	90
9.	Massachusetts	70
10.	(tie) Arizona	67
	(tie) North Carolina	67



Source: *SEC Annual Report on the Dodd-Frank Whistleblower Program, Fiscal Year 2012*, **tinyurl.com/cu8mzjg**.

PHOTO BY STOCKBYTE/THINKSTOCK

A total of 3,001 tips were filed, and 143 enforcement judgments and orders were issued during the fiscal year that may be eligible for whistleblower awards. The Dodd-Frank Act allows the SEC to pay financial awards to whistleblowers who provide information that leads to a successful SEC enforcement action with more than $1 million in sanctions.

The SEC's first award under the whistleblower program totaled nearly $50,000 and was given Aug. 21 to an informant whose identity remains anonymous. The whistleblower is expected to receive more if additional judgments in the case lead to more funds being collected in sanctions. Whistleblowers can receive between 10% and 30% of the sanctions collected, and awards are paid from the Investor Protection Fund established by Congress.

The annual report is available at tinyurl.com/cu8mzjg.

MANAGEMENT ACCOUNTING

■ The Department of Justice (DOJ) and SEC released a 120-page guide providing a detailed analysis of the agencies' approach to enforcement of the Foreign Corrupt Practices Act (FCPA), which is designed to prevent bribery and corruption of foreign officials by companies seeking to gain a competitive business advantage.

The law was enacted in 1977, and enforcement has been stepped up in recent years as business has become more global. In every full year since 2007, the SEC has announced FCPA enforcement actions against at least 10 companies, according to a list provided on its website. Enforcement actions were much less frequent before 2001. In 2010, the SEC created a special unit to enhance enforcement of the FCPA.

The release by the DOJ and SEC is designed to aid businesses practicing in foreign markets and is available at tinyurl.com/aujcgnv. The guide contains a chapter that describes the FCPA's accounting provisions, and defines who is considered a foreign official and the difference between proper and improper gifts.

In one chapter, the guide explains that the FCPA's accounting provisions operate in tandem with the anti-bribery provisions and prohibit off-the-books accounting.

The "books and records" provision requires companies to keep records that accurately and fairly reflect transactions and dispositions of assets. The "internal controls" provision requires companies to maintain internal accounting controls that will ensure management's control, authority, and responsibility over the firm's assets.

According to the guide, a company's internal controls and compliance program should be tailored to its specific circumstances with regard to operational realities and risks such as:

- How products or services get to market.
- The nature of the workforce.
- The degree of regulation.
- The extent of government interaction.
- The degree to which the company operates in countries where there is a high risk of corruption.

PROFESSIONAL ISSUES

■ The number of CPAs in Congress grew as a result of November's elections.

Rep. Brad Sherman held off Rep. Howard Berman in an unusual and hotly contested race between two congressional Democrats in California's 30th District as all eight CPAs serving in the House of Representatives won reelection.

In addition, Republican Tom Rice won in South Carolina's newly created 7th District, and Democrat Patrick Murphy unseated Rep. Allen West in a tight race in Florida's 18th District.

The total number of CPAs in the House rose to 10, and the number of CPAs and accountants in Congress jumped to 12. The two accountant senators, Mike Enzi (R-Wyo.) and Ron Johnson (R-Wis.), were not up for reelection in 2012.

In addition to Sherman, the other CPAs who won reelection were:

- Rep. Mike Conaway (R-Texas)
- Rep. Bill Flores (R-Texas)
- Rep. Lynn Jenkins (R-Kan.)
- Rep. Steven Palazzo (R-Miss.)
- Rep. Collin Peterson (D-Minn.)
- Rep. John Campbell (R-Calif.)
- Rep. James Renacci (R-Ohio)

In February 2011, Sherman and Conaway created the Bipartisan Congressional CPA Caucus. The informal group is dedicated to discussing and formulating innovative policy approaches to issues of interest to CPAs such as tax administration and compliance, and accounting and auditing standards. The caucus also seeks to reduce the compliance burden of tax laws.

FYI

■ In a post-election change, Elisse Walter replaced Mary Schapiro as SEC chairman.

President Barack Obama named Walter, who has been an SEC commissioner since 2008, as Schapiro's successor. After leading the agency's response to the financial crisis, Schapiro stepped down Dec. 14.

Walter can serve without Senate approval through December because the Senate confirmed her when she was named a commissioner. She served as acting chairman during January 2009. Before Walter's appointment as an SEC commissioner, she served as senior executive vice president for regulatory policy and programs for the Financial Industry Regulatory Authority.

"She is a very able and experienced regulator," AICPA President and CEO Barry Melancon said in a statement. "We are committed to working with her on the many financial and accounting matters of importance to CPAs and investors alike."

Schapiro became chairman in January 2009 as the United States was struggling to break free of the grip of a crisis that put some of the nation's largest financial institutions on the brink of collapse.

■ U.S. representation on the IASB won't decrease with the end of Paul Pacter's term, as another U.S. representative, Mary Tokar, has been appointed to the board.

Tokar, a CPA, has served more than 10 years as the global leader for KPMG's

international financial reporting group, helping companies around the world adopt and apply IFRS. She previously worked as the SEC's senior associate chief accountant for international issues.

She was scheduled to join the IASB in January for a term that will end June 30, 2017, when she will be eligible to have her term renewed for three years. Her appointment could soften concerns that the IASB will shun U.S. representation and influence as a result of the SEC's continuing indecision on whether to allow or require U.S. issuers to file financial statements prepared in accordance with IFRS.

Tokar's appointment means that the number of IASB members from the United States will remain at three.

DRAFTS OUTSTANDING

■ FASAB

Deferral of the Transition to Basic Information for Long-Term Projections. Comment deadline: Jan. 31. ED available at tinyurl.com/a5swav9.

■ IFAC

Professional Accountants in Business Strategy and Work Plan for 2013–2016. Comment deadline: Jan. 31. ED available at tinyurl.com/cneyfue.

Project and Investment Appraisal for Sustainable Value Creation. Comments deadline: Feb. 28. International Good Practice ED available at tinyurl.com/bj4wv9j.

International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*. Comment deadline: March 14. ED available at tinyurl.com/bskkes4.

IPSASs and Government Finance Statistics Reporting Guidelines. Comment deadline: March 31. Consultation paper available at tinyurl.com/9pdf779.

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements. Comment deadline: April 30. ED available at tinyurl.com/chuyq6h.

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements. Comment deadline: April 30. ED available at tinyurl.com/ce8u6u9.

■ PCFRC (AICPA)

Proposed Financial Reporting Framework for Small- and Medium-Sized Entities. Comment deadline: Jan. 30. ED available at tinyurl.com/chg62xo.

■ ARSC (AICPA)

Proposed Statements on Standards for Accounting and Review Services, *Review of Financial Statements* and *Review of Financial Statements—Special Considerations*. Comment deadline: April 26. ED available at tinyurl.com/7j9utzu. ❖

When Parties Come Knocking for Client Records

by Joseph Wolfe

CPA firms either maintain or have access to numerous types of client records and related working papers. Requests for access to copies of such records can arise from multiple sources, including current and former clients, lawyers, civil and criminal investigators, lenders, and others. All requests should be made in writing.

The obligation of a CPA firm to respond to these requests is governed by professional standards, state board of accountancy regulations, state and federal law, and regulatory bodies. Before responding, a CPA firm should consider all applicable standards, statutes, and regulations. Often, the requesting party seeks an immediate response while actions affecting the CPA firm's client, such as extending a loan, securing a construction bond, or responding to a regulatory inquiry, are pending—thus creating impediments to a prompt reply.

Additional issues to consider include the standing of the parties requesting the records, the types of records requested, the time frames sought to produce the records, the format of the records being requested, and the resources necessary to identify, retrieve, reproduce, and submit copies of records.

CPA firms should consider designating a records custodian responsible for coordinating the responses to all such requests. The custodian will develop expertise over time in this area, and that continuity will help minimize errors and wasted time. Ultimately, this protocol will help to manage the costs associated with responding to records requests, as processes are developed and required consultations with legal counsel can be minimized.

REQUESTS FROM CLIENTS AND FORMER CLIENTS

The most common types of records requests come from clients, former clients, or parties associated with them. With respect to the standing of the party requesting the records, the first question to consider is whether the party is the client or former client, or an authorized representative.

Business clients often are closely held and are corporations or partnerships, which can lead to other questions to consider before responding, such as whether the client has a COO or CFO, or whether one of the owners always engaged the CPA firm and provided requested information, but there is joint ownership. The requesting party should state in writing its relationship to the client. The CPA firm should then consider whether this representation is consistent with the information the CPA firm knows about the client's business.

This is important because it is not unusual for the operators or owners of a client business to become embroiled in a business dispute and demand copies of records despite having had little or no prior contact with the CPA firm. If it cannot be readily determined whether the requesting party is authorized to receive copies of records on behalf of the client's business, it may be necessary to consult with legal counsel prior to responding.

REQUESTS FROM THIRD PARTIES

Records requests may come from third parties, such as shareholders, lenders, mortgage brokers, vendors or customers of clients, attorneys, regulators, and civil or criminal investigators.

Before responding to an inquiry, a CPA firm should consider the source. Is the request emanating from a regulator, a representative of a department of revenue, or a criminal investigator? When in doubt, consult with your firm's legal counsel. It is possible that a subpoena should have accompanied the request. In addition, other advice may be needed to avoid running afoul of investigative authority vested in the requesting party.

Also, consider the potential risk to the CPA firm if it provides client records to a third party. In addition to privacy and confidentiality concerns, a CPA firm can unintentionally expose itself to the risk of claims from third parties, who may assert reliance on the records provided by the CPA firm to make a decision or enter into a business transaction. The ability of a third party to assert such claims varies by jurisdiction.

RESPONDING TO THE REQUEST

If a document request is in the form of a subpoena or other legal documents, the CPA firm should consult with its attorney and professional liability insurer before contacting the client or responding, in order to ensure that any prohibitions or limitations on sharing the information are fully understood and addressed appropriately. The costs to research and respond to document requests can be significant; follow the advice of counsel regarding research to be conducted and documents to be produced. Upon learning of past or pending litigation involving the client or the client's business, inform the attorney, as confidentiality agreements or court orders may affect the production of documents.

Requests to produce documents often arise in connection with business disputes that involve clients, either directly or indirectly. Absent an obligation to keep knowledge of the request confidential, such as the issuance of a grand jury subpoena, clients should be provided with a copy of the document request or subpoena. CPA firms also should consult with their client prior to responding to a subpoena.

If a subpoena is issued, the client may request that the CPA firm object to either the scope of the document request or the

PHOTO BY FUSE/THINKSTOCK

nature of documents being requested, which may include confidential information such as trade secrets, expansion plans, or product development. If the request is not via a subpoena, the client may request that the CPA firm refuse to provide information in the absence of a subpoena. Again, the CPA firm should consult with its attorney regarding its response to a subpoena, including any objections that should be asserted.

When practicable, obtain the client's written consent to produce documents in response to the request. Sometimes, due to the nature of the documents being requested, a shareholder or partner in the client's business will be affected by providing the documents. In those cases, obtain that person's written consent as well. If the client, shareholder, or partner objects to the production of some documents, seek his or her review and approval before responding to the request. Also ask the individual to consult with his or her attorneys prior to responding.

Do not surrender original documents. Instead, provide copies and maintain a complete set of the documents being produced.

Occasionally, disputes arise among management and owners of a client business regarding responses to records requests. In such cases, the CPA firm should consult with its attorney prior to responding to the request. In other cases, it may become necessary to refuse to respond to the request without a valid subpoena.

LEGAL AND PROFESSIONAL STANDARDS

When responding to records requests, CPA firms must consider all applicable professional standards, regulations, and statutes pertaining to client confidentiality, privacy, and requests to produce records. These include, but are not limited to, the following:

- AICPA Code of Professional Conduct (the AICPA Code);
- State board of accountancy regulations;
- Regulations issued by the SEC, PCAOB, and state securities regulators;
- Regulations and laws applicable to the client's industry;
- State privacy laws;
- Circular 230, *Regulations Governing Practice Before the Internal Revenue Service* (31 C.F.R. Part 10);
- Internal Revenue Code (IRC) Secs. 6103(c) and 7216; and
- Federal privacy laws, including the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and the Health Information Technology for Economic and Clinical Health (HITECH) Act.

AICPA Code Interpretation 501-1, *Response to Requests by Clients and Former Clients for Records*, addresses the responsibilities of AICPA members in such situations. Requests may be received for copies of both client-provided records and member-prepared records. It is important to understand the distinction between these types of records. Guidance on this and other questions that arise regarding responsibilities to produce records, the format of the records to be produced, the recovery of costs to research and produce copies of records, and other matters are addressed directly in this ethics interpretation.

State board of accountancy regulations may be more restrictive than the AICPA Code with respect to responding to requests for documents. If the client operates in a regulated industry or is a publicly traded corporation, rules issued by applicable regulators also must be considered.

State privacy laws may restrict the ability to produce records containing personally identifiable information, such as names, Social Security numbers, or taxpayer ID numbers that use Social Security numbers, without the express consent of affected individuals. Information on state privacy laws is available on the AICPA Information Management and Technology Assurance Section's page at aicpa.org/IMTA.

Tax return preparers have additional considerations. Circular 230 addresses responsibilities with respect to records in Section 10.28, *Return of Client's Records*. IRC Secs. 6103(c) and 7216 limit the use and disclosure of information obtained in connection with the preparation of U.S. tax returns, and Rev. Proc. 2008-35 provides rules on how to obtain consent to use or disclose such information. Review these rules and obtain required signed authorizations prior to releasing records.

CPA firms with clients in the health care industry must consider the application of HIPAA and the HITECH Act, each of which addresses maintaining the confidentiality of protected health information. This is particularly important when requests are made for patient billing records processed by the CPA firm.

Responding to requests for records is an ongoing issue for all CPA firms. Maintaining centralized control over replies to such requests, designating a records custodian, and maintaining current knowledge and training regarding applicable professional standards, laws, and regulations can help simplify a task that may be difficult and time-consuming. Implementing protocols and procedures for such responses will help to minimize the risk of experiencing disputes, disciplinary actions, and malpractice claims related to records production. ❖

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This article provides information, rather than advice or opinion. It is accurate to the best of the author's knowledge as of the article date. This article should not be viewed as a substitute for recommendations of a retained professional. Such consultation is recommended in applying this material in any particular factual situations.

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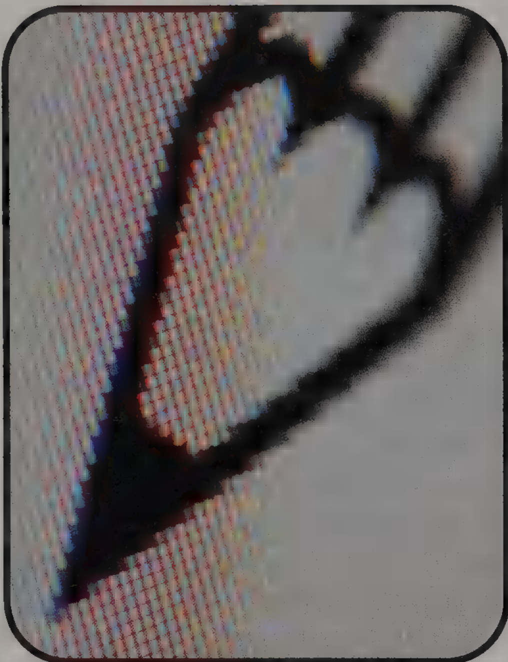

MD&A Reporting Tips

Deciding what to include in the management discussion and analysis (MD&A) section of a financial report isn't always easy. During a session at the AICPA Conference on Current SEC and PCAOB Developments, Katherine Gill-Charest, CPA, the chief accounting officer at Viacom, and Brian Lane, a corporate securities lawyer at Gibson, Dunn & Crutcher, offered tips on crafting an effective and compliant report.

✔ ***Use plain language, and keep the overview brief.*** Good MD&A reports minimize jargon and provide plenty of tables. "Assume that one of your directors is Rip Van Winkle and they woke up at the end of the quarter," Lane said. "And they're like, 'Hey, I just woke up. How did it go?' That's the overview. OK, sales are up 8%, and here's why."

✔ ***Give a top-down analysis.*** Focus on the most important items first, and save the minutiae for the bottom of the report—if you include it at all. And remember: Projections are not required. "You do have to talk about known uncertainties and how they could impact the future," Lane said. "But you don't have to make projections."

✔ ***Pay attention to what your competitors and peers are disclosing.*** The SEC is going to look at them. "They are going to look at you in that same lens," Lane said. "So you can anticipate comments by looking at your peers."

✔ ***Answer the most important question: "Why?"*** "There's the 'who,' 'what,' 'where,' and 'when,' but then there's the 'why,'" Lane said. "And that's really what MD&A is about."

✔ ***Make risk factors less boilerplate.*** It's a mistake to include the same risk factors in the same order with the same explanation year after year, Lane said.

✔ ***Quantify and describe effects of multiple factors.*** If you say that the results for the quarter were down based on foreign currencies, product mix, and the economy, Lane said, the SEC will ask: How much was attributable to the economy, how much to your unfavorable product mix, and how much to foreign currencies?

✔ ***Combine your charts.*** In the SEC Form 10-K, don't have one chart showing 2012 data and another chart showing 2011 data. "That's painful to read," Lane said. Plot the information from both years on one chart.

✔ ***Use your disclosure committee as a gateway.*** Have a checklist for the disclosure committee to consider. It could include items such as: reviewing financial covenants; taking a close look at liquidity and cash reserves; monitoring changes in legislation and regulation; considering problems with customers or suppliers; considering the effect if your company is disproportionately dependent on one product or segment; watching for significant swings in results between quarters—those may need to be disclosed; and monitoring the company's litigation developments.

✔ ***Ask key personnel for good news—and potential bad news.*** It's important to look for the vice president who seems worried and ask, "What's causing you to frown, other than the choices in the company cafeteria?" Lane said.

✔ ***Seek a broad, balanced perspective.*** Consult with a wide range of departments—in addition to finance, Gill-Charest said. Talk to legal, planning, and sales representatives—anyone who has a pulse on the organization. Create a cohesive working group of people who touch base frequently and talk about what's going on at the company.

*—By **Ken Tysiac** (ktysiac@aicpa.org), a* JofA *senior editor.*


Left brain? Right brain?
Which makes sense for you?
Level Premium Term Life Plan
Pay the same rate for a 10- or 20-year term—when you know what you want and when you want it.
Don't have a smartphone? Visit www.cpai.com/lptlqr
CPA Life Plan
Coverage that costs less to start, and is yours to keep until age 80—protection for the long haul.
Don't have a smartphone? Visit www.cpai.com/lifeqr
AICPA
AICPA Insurance Trust
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FROM CGMA MAGAZINE
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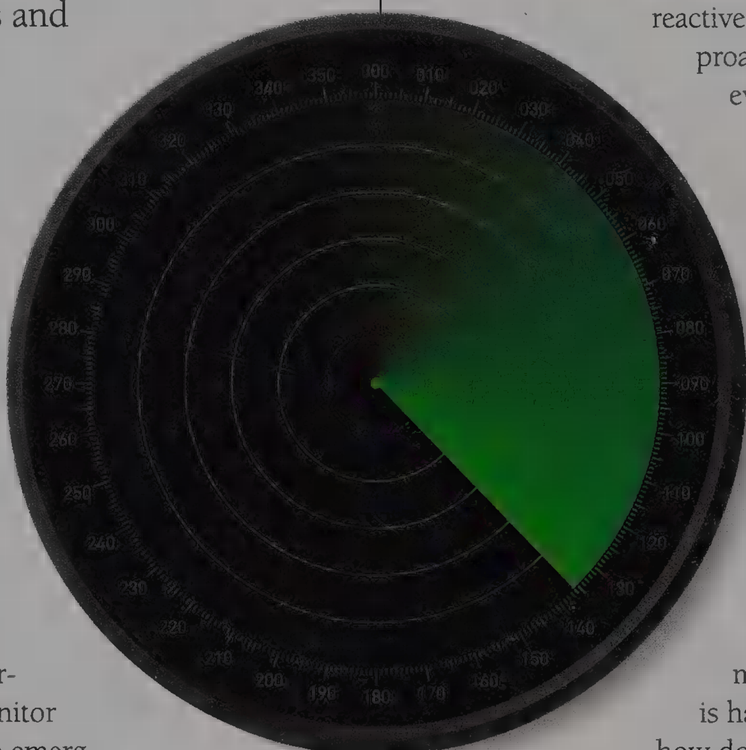
Softer Skills for a Broader Role

Internal auditors were once thought of solely as the go-to people for all issues relating to financial controls and governance. But in the wake of the global financial crisis, internal auditors have become increasingly relied upon to identify operational risks and provide strategic insight on everything from mergers and acquisitions to IT system implementations.



"A lot of [boards] have begun to realize that internal audit can be very effective in helping them understand what goes on when they are not there," said Richard Chambers, president and CEO of the Institute of Internal Auditors (IIA). "[And] … audit committees are looking to internal auditors to help avoid surprises. Internal auditors must monitor not only traditional risks, but also emerging risks—things that nobody might have on their radar. We have to understand the geopolitical and economic risks that our enterprises face."

As the role expands, so too has the set of skills needed to do the job. An analytical mindset and critical thinking were the most sought-after skills for new internal auditors in all regions in the past year, according to IIA research, which found operational risk to be the top priority for shareholders and internal audit agendas.

Better communication and relationship-management skills are also in demand. Being able to get across the right message—and being able to effectively adapt the presentation of that message for different audiences—can be the difference between internal audit playing a largely reactive, assurance-based role or being a proactive business adviser. After all, every communication channel, whether it is with senior managers or audit committees, requires a different strategy.

"When you are with managers, you are in persuasive mode, communicating with them in order to persuade them to do something," said Phil Tarling, vice president of the Internal Audit Centre of Excellence at telecom equipment-maker Huawei Technologies. "When you are with the audit committee, you are more in an explaining mode—what is happening, what has gone on, and how do we get to the end results."

An important part of effective communication, regardless of the target, is being able to display an understanding of the business.

"For example," the IIA's Chambers said, "if I am going to try to build and sustain any relationship with the CIO, I'd better have some understanding of the IT environment, IT issues and challenges. I need to sit down and talk to him or her about things like cloud-computing risk. So you have to

build credibility."

A major role of an internal auditor is to conduct interviews for assessments. Too many auditors "seem to rely on a set of prepared questions and do very little digging into the responses they receive," said Richard Fowler, a senior audit specialist at shipbuilder Huntington Ingalls Industries.

"Interviewing is a trainable skill, but other than those auditors who are also trained in fraud detection and investigation, there are few who receive training in interviewing techniques," Fowler said.

Too few audit managers and directors within business think soft skills training is worth the expense, Fowler said, noting that he had to pay for his own lessons. The unfortunate irony of such a short-sighted approach to soft-skills training is that effective communications can drive efficiencies and save organizations money.

Carolyn Dittmeier, CPA, the chief audit executive of Italy's postal service, Poste Italiane, has firsthand experience of how effective communication can help internal audit bring about positive change.

At Poste Italiane, she said, "internal audit pushed on certain areas of information technology, both in terms of efficiency and security, such as the fact that certain areas were manual and should be automated. And they pushed, and pushed, and pushed in the right way, and little by little they saw it change, and the IT area improved. That was the advisory part.

"And then the audit committee and senior management see change that wouldn't have happened, or wouldn't have happened as quickly, if it hadn't been for internal audit," added Dittmeier, who manages more than 400 auditors. "It's this play between making sure things change by convincing in the right way that's important."

For a full version of this story, and for four key communication tips, please read "Internal Audit: The Importance of Being 'Soft,'" by Arvind Hickman, tinyurl.com/cd4bj4u.

—*Jack Hagel, editorial director*
CGMA Magazine

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ILLUSTRATION BY JAMES STEINBERG/GERALD & CULLEN RAPP

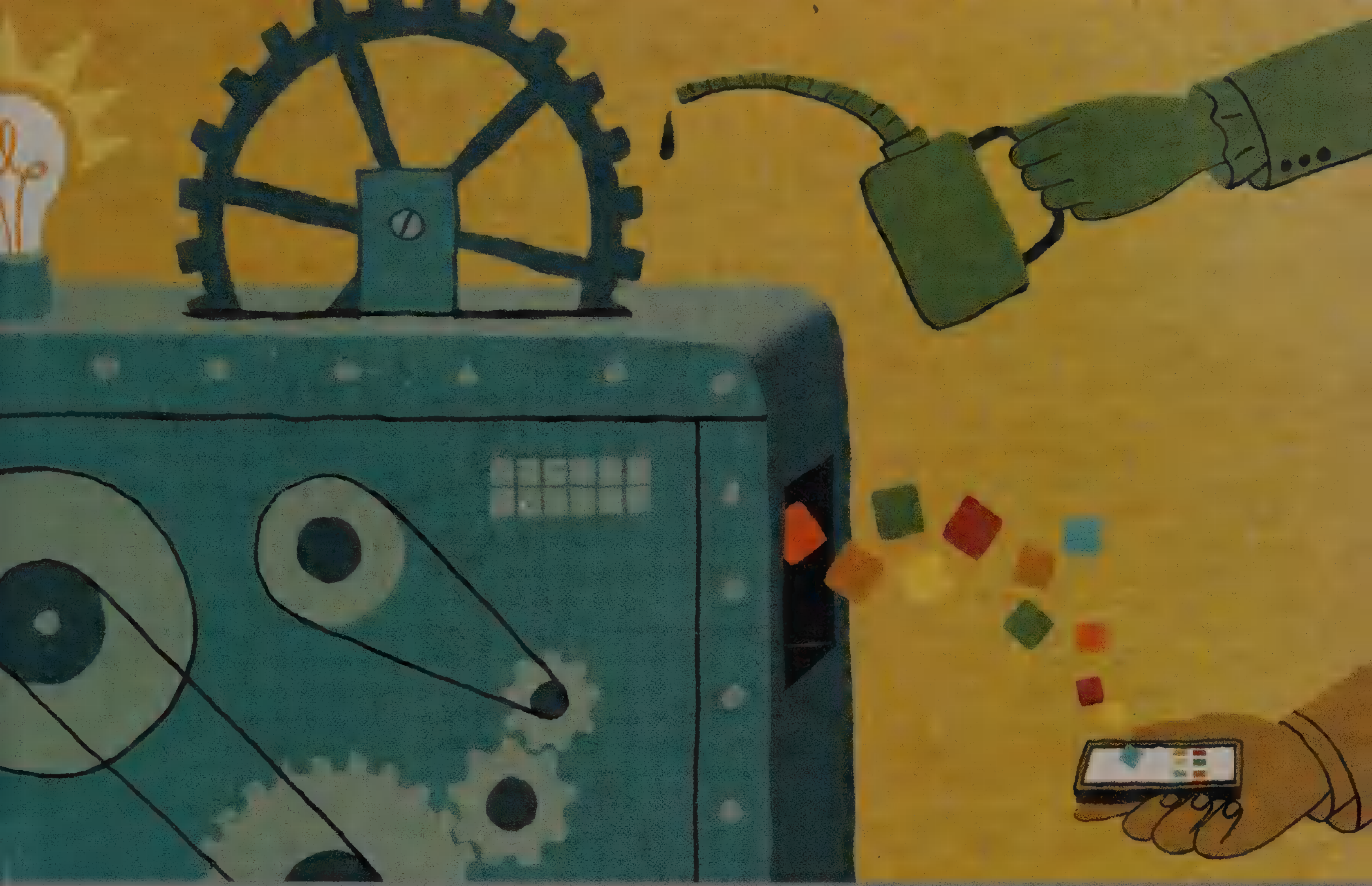
How to Develop and Publish a Mobile App

Compelling idea and solid plan are key to placing product in an app marketplace.

by Jeff Drew

When Susan Bruno set out to launch a mobile application to help women gain control of their finances, and Leonard Wright decided to develop an app to enhance his client interactions, neither wealth manager could foresee the dizzying array of detours and dead-ends they would encounter on the road to the app marketplace.

Bruno, CPA/PFS, managing partner of Connecticut-based Beacon Wealth Consulting LLC and co-founder of DivaCFO LLC, was forced twice to find a new vendor to write the code for her app, DivaDocs. Wright, CPA/PFS, a wealth management adviser in San Diego and co-host of a weekly radio show on financial planning, saw Apple



reject his app multiple times. Both financial planners lost deposits when the developers they hired to build their apps either closed up shop or simply disappeared.

How can CPAs interested in launching a mobile app avoid the types of problems that plagued Bruno and Wright? What are the best practices in mobile app development? This article lays out a series of steps CPAs can follow as they seek safe passage through the mobile app minefield.

Fill a Need

CPAs should not pursue the creation of a mobile application without a clear and compelling reason to do so. The road to submitting an app to Apple's App Store or one of the myriad Android app stores is riddled with potholes that can knock the project off course or kill it, costing CPAs significant time and money.

"Don't build an app just to have an app," said Ben Schell, a website and mobile app developer and owner of Blue Pane Labs. "You're going to end up with something that nobody really wants to use."

To avoid that, CPAs should be able to answer "yes" to the following questions:

- Would the application address an unmet need in the marketplace?
- Would delivery to mobile devices enhance the value of the content or functionality the application would provide?

If those questions are answered in the affirmative, the next step is to determine whether the same functionality could be delivered as well or better through a mobile website. That decision requires an understanding of the differences between mobile apps and mobile websites:

- A mobile app is a software application designed to run on the "native" operating system of a mobile device. Native apps are not interchangeable, said Michael Ham, vice president of operations at CPA2Biz, the AICPA's for-profit technology subsidiary and provider of technology development to the Institute. A native app designed to work on Apple's iOS will not work on Android and vice versa.
- A mobile website is a website optimized for mobile devices. The content is reformatted—and often streamlined—to provide a better experience on mobile devices than the full website does. Mobile websites may also feature enhancements for touchscreen navigation. A single mobile website will work on a broad range of mobile browsers and devices.

This article focuses on the development process for native apps. For an expanded comparison of native apps and mobile websites, see Exhibit 1.

For CPAs, native mobile apps should do at least one of the following, according to Ham:

- Expand the firm's product or service offerings using the built-in capabilities of smartphones, such as cameras, global positioning systems (GPS), etc.

- Enhance the firm's brand.
- Initiate interactions with clients that reflect the changes in communication methods being used at the client level. In other words, if clients are texting and emailing via mobile devices, their CPAs need to engage them in the same manner.

Bruno suggests that CPAs ask themselves this question: "Can I leverage my expertise and create a new virtual business from what I already know?" In Bruno's case, she knew which vital personal and financial documents her wealth management clients have to gather when they work with her. She then applied that knowledge to design DivaDocs as a "scavenger hunt" that helps women (and men) track down those documents in a "fun way."

Mobile apps create all kinds of possibilities for CPAs to inform, assist, and interact with clients (see Exhibit 2), but CPAs should resist the temptation to include too many features in a mobile app, especially their first one, said Ham, who believes that an app needs to do only one or two things well to merit consideration for development.

"Instead of having one app that does 50 things, it's better to have 50 different apps," said Ham, who led CPA2Biz's development of the *JofA*'s iPad app and the CPA Exam Aid app for iOS and Android smartphones.

Mobile apps should not replicate the website of the CPA or the CPA's organization, Schell said. Instead, apps should provide new content or functionality that offers value to the target-user market.

Determine the App's Look and User Interactions

Once it has been determined what the app will do, decisions must be made on what the app will look like and how it will work. Of particular importance is the appearance and functionality of the user interfaces (UIs). A UI refers to a meshing point where the user interacts with an application. UI elements include the design of menus and icons, the functionality of touchscreens, and the ease of navigation to the application's various features.

For the visual elements, a professional graphic designer with experience designing mobile apps is a good option if the CPA's organization does not have such capabilities in-house. Also, if the CPA pursuing the app hasn't yet engaged someone with IT knowledge to help with the development process, this would be the time to do so. The right consultant can provide the expertise and experience needed to properly analyze apps. Some of the performance factors with apps are so subtle that it often takes a trained technical eye to spot flaws, Ham said (see Exhibit 3).

An IT consultant also can assist with the toughest and riskiest part of the process—the vetting and selection of a vendor to write the code for the app.

Proceed With Caution

CPAs who opt to hire a contractor to build their app must venture into the world of mobile-app vendor vetting and selection, a largely lawless land that Bruno and Wright both labeled the "Wild West."

The analogy is appropriate. There's no official certification to distinguish the good developers from the bad developers.

"Anyone can say they are a mobile app developer," Ham said.

And anyone can take a deposit, usually 50% of the overall cost, and then disappear with the money. That happened to both Wright and Bruno, whose bad experiences illuminate some of the dangers lurking in Dodge City (see sidebar, "Two

EXECUTIVE SUMMARY

- **Mobile applications can offer CPAs new ways to engage clients and colleagues on their smartphones and tablets.** Opportunities exist in the areas of content delivery and enhanced, interactive communications.
- **Do not invest time and money into developing a mobile app unless there is a clear and compelling reason.** Apps should provide a new product, service, or form of interaction with clients in a manner that is significantly enhanced by delivery through a mobile device. Don't build an app just to build an app.
- **Once a strong app idea is established, decide whether to build a mobile-optimized website or a "native app."** Mobile websites are hosted on the internet and are designed to work on multiple mobile devices and operating systems. Native apps are designed to be downloaded to a device and work exclusively on that platform. For example, an iPhone app running on Apple's iOS won't work on an Android smartphone or tablet.
- **CPAs who aren't website experts should consider hiring a consultant who can advise on app design, vendor vetting, device selection, and app store submissions.** Look for experience with app development when choosing a consultant.
- **Choose which devices and operating systems will run the app.** Keep in mind that the costs will rise with each version of the app that is created.
- **Once the design and functionality of an app is mapped out, the next step is to find someone to write the actual code.** This is the most vexing part of the process. Without an official body to sanction app developers, it's difficult to tell the good vendors from the bad ones.
- **The costs of building an app can range from a few thousand dollars to well into six figures.** Budget accordingly.
- **Make sure to do thorough quality assurance testing on your app before submitting it to an app store.** The release of an app that doesn't work right will hurt your brand and could lead to costly revisions.
- **The Apple App Store puts app submissions through a thorough review process that can take weeks and often results in a rejection.** Understanding the App Store's rules and developing the app to comply with App Store policy is the best approach to break through Apple's red tape.

***Jeff Drew** is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact him at jdrew@aicpa.org or 919-402-4056.*

Exhibit 1 Native Apps vs. Mobile Websites: Pros and Cons

	Native Apps	Mobile Websites
Advantages	■ Can integrate directly with mobile device capabilities such as cameras, global positioning systems, and built-in apps such as address books and maps.	■ Can function on different mobile devices and operating systems, eliminating the need to write different code for different platforms. This can reduce costs.
	■ Usually perform faster than mobile websites because the code is running on the device itself, not on a server accessed over the internet.	■ Are easier to update. Users don't have to download new versions to access new features or improve functionality.
	■ Can be designed to work without having a live internet connection.	■ Can provide most of the functionality of native apps that require a live internet connection.
Disadvantages	■ Can be costlier because different versions must be developed for each mobile operating system.	■ Are unable to integrate with mobile devices' capabilities as apps can, with some exceptions.
	■ Can be required to drop features or change design to meet the requirements of mobile app store vendors.	■ Often are not accessible without a live internet connection, though again there are exceptions.
		■ Usually aren't as fast as native apps.
	■ Require users to download updated versions to access new features or improved functionality. In addition, for iOS apps, the App Store's review process can take weeks for each update.	■ Can lose their cost-savings advantage if the website's design requires advanced features such as HTML5 or different versions for the smartphone.

CPAs and App Development: Lessons Learned").

"Vendors can say anything," Bruno said. "They overpromise and under-deliver."

Steps CPAs can take to protect themselves when selecting a mobile app developer, or a mobile website developer, include:

- Obtain a list of apps or mobile websites developed by the vendor. Test those apps and gauge their performance on your mobile devices and the types of mobile devices you want to be able to run your app.
- Contact customers of the vendor to see what their experience was like. What went well? What could have gone better? Would they work with the vendor again?
- Request to see full technical specs for the app or mobile site that show in detail what the site would look like, how it would work, and whether the code used would allow for changes to function and design based on feedback in testing. If the vendor won't provide this information, do not sign anything with the vendor. But don't balk when the vendor says the tech specs will come with a cost. "It's like an architectural blueprint and worth every penny," Bruno said.
- Make sure the contract spells out in detail what the developer will produce, what the deadlines will be, and what consequences are attached to vendor failure to live up to the contract.
- Don't rush into a contract. You need to negotiate terms from a position of strength. Don't scramble to put together an app just to meet an artificial deadline.
- Negotiate not only the final price, but also what you will pay upfront. While 50% is a common deposit for mobile app development, it is by no means the only option.
- Talk to as many developers as possible. This is where your consultant can help with initial interviews and screening. Your goal should be to create as much competition as possible to develop your site.

Set a Budget

The cost of building an app can range from a few thousand dollars to well into six figures. Bruno, for example, invested about $100,000 to bring her app to market—a price tag that included not only the app developer and graphic artists for design, but also paying a full-time project manager to oversee the DivaDocs app and

Two CPAs and App Development: Lessons Learned

Susan Bruno and Leonard Wright had dramatically different visions for their mobile apps but ran into similar problems during the development process. Following are their stories and the lessons they learned about building and launching mobile apps.

The Wright Stuff

Wright's goal for his app was straightforward: communicate with his clients in a manner more welcoming and engaging than email.

The idea came to him during dinner with a client. During the discussion that evening, which focused on how Wright communicated with his clients and also on the communication methods he preferred to use on his smartphone, Wright realized that while he deleted more than half of the emails he received, he always took notice of the content delivered by apps he had downloaded.

"If I have an app, I have an app for a reason, and that reason is that I'm interested in whatever that app delivers to me," he said.

After that dinner, Wright paid particular attention to how his clients interacted with their mobile devices. He noticed that in meetings and at meals, his clients often left their smartphones on the table. When the device made a sound indicating a message had come in, the clients usually would take a quick look at their screen. When Wright asked them what they had glanced at, they often told him that they were checking on alerts to content delivered to their phones by various apps. The clients would not open the message and access the full content during their meetings with Wright, but they would take note of what was delivered and check it more thoroughly after the meeting.

Those client conversations convinced Wright that the best way to interact with his clients was by developing an app that clients would download. Wright could then deliver financial information and other content of interest to his clients.

Wright sketched out the concept for his idea in 10 minutes on a napkin; then he began the process of bringing his app from concept to reality. He selected a veteran business executive-turned-mobile app developer in Kansas City, Mo., who was highly recommended by one of Wright's clients. The developer worked with Wright on the app, making changes at Wright's request and adding features. It appeared that Wright had found the perfect person to develop his app. That is, until that person, and Wright's deposit, disappeared.

"[He] never returned phone calls, never returned emails," Wright said. "He was just gone."

Forced to start from scratch, Wright found a Nevadan, Lisa Wark, who had taught herself how to write code for mobile apps. She was able to re-create his app for the iOS and Android operating systems for smartphones.

Next came the task of submitting the app to the Google Play and Apple iTunes app stores. Submission to the Google Play store went smoothly. The mobile application was up and available for download within 24 hours.

It took three months to achieve the same result with Wright's iPhone app. Apple rejected the app three times for a variety of reasons. Apple would not allow it to have YouTube videos, so those had to be removed. Apple also objected to some of the design elements, all the way down to the colors of some of the text.

"Apple wants everything to have the same look and feel," Wright said.

Despite the setbacks and delays in the app development process, Wright believes apps are the future of CPA-client communications and that CPAs, especially those who do personal financial planning, can leverage the technology to create a competitive advantage.

"The key here is accessibility to what it is you want to deliver on everybody else's time schedule," he said.

The Story of a DivaCFO

DivaDocs is part of Bruno's DivaCFO concept, which includes a website and blog. Bruno set up DivaCFO LLC to own the rights to DivaCFO's assets, including DivaDocs, and to protect the owners' personal assets. DivaDocs represents a roll of the dice that Bruno recommends CPAs take on only if they have another strong source of income.

Bruno also advises CPAs against signing any agreements with app vendors that don't agree to provide full technical specifications and wire framing to show how the app would look and detail how it would work. In addition, CPAs should consider only vendors that can produce dynamic code, a type of programming language that allows for rapid modifications to functionality and design.

These are lessons learned the hard way. The first vendor Bruno selected did not provide tech specs and could write only in static code, which could not accommodate changes in functionality during the development process. That was unacceptable to Bruno, who anticipated having to make changes to her app, which helps users find and organize financial documents by playing a game that's a mix of a scavenger hunt and

(Continued on page 30)

the DivaCFO blog and website. Other costs included engaging experts to provide media training and set up TV and radio interviews, and hiring attorneys to set up an LLC for the DivaCFO concept and to protect intellectual property. Wright, in contrast, spent between $3,000 and $4,000 for his app.

CPAs need to align their resources and goals for the app with how much the design and development will cost. To do that, CPAs should consider the main cost drivers in launching a mobile app:

- How much of the design and coding is customized. The more customization, the higher the price. The use of existing templates and coding can reduce costs but also places limits on the functionality and features that can be included in the app.
- The quantity and complexity of the features.
- The complexity of the functionality.
- The number of additions and changes made during the development process. This can range from new features to redesigned user interfaces. "It's kind of like building a house," Bruno said. "… The [final cost] is going to be 50% more."
- The number of versions that must be produced. Tablets and smartphones require different specifications, as do different operating systems. If a CPA decides to build an app for the iPhone, it will cost "X" amount of money based on the other factors listed above. A decision to design apps customized for the iPad as well as the iPhone could double the cost, Ham said. The price for developing the app for the Android as well as Apple's iOS could be double the price of building the app for just one operating system. "There could be up to four different versions you have to create," Ham said. That could cost four times as much as building just one app, though Ham cautions that costs depend on scope and that it's difficult to predict how much a developer's final bill would be.

Exhibit 2 Three Types of Mobile Apps

Mobile apps produced by CPAs likely would fall into one or more of the following categories:

- **Content apps** provide information of interest to users' mobile devices. For example, a CPA firm with business clients can deliver targeted and timely news directly to the clients' smartphones and tablets, giving them the competitive advantage of quicker and more convenient access to the information and intelligence used to make smart, swift business decisions.
- **Calculator apps** allow users to do quick calculations. For example, numerous income tax apps take input such as an individual's yearly earnings and deductions and immediately produce an estimate of the income tax that will be owed. Specialized apps, such as child support calculators, have been created for narrowly defined markets.
- **Toolkit or checklist apps** allow users to track steps or progress in a process. Because these checklists are available via mobile devices, users don't have to be at a personal computer or carry around a sheet of paper to access them. For CPAs, checklist apps could help with tasks such as performing internal or external audits on-site.

Source: Michael Ham, CPA2Biz.

Pick the Best Device(s) for an App

While the cost factor should carry a lot of weight in the decision on device and operating system for an app, there are other factors to consider:

- There are significant differences in the size and purpose of smartphones and tablets. Smartphones, for example, are ideal for the delivery of content that can be quickly consumed, while tablets are superior for reading long-form material.
- User smartphones almost always have an internet-access plan with a telecommunications carrier. Many tablet users can connect to the internet only via a Wi-Fi connection.
- Smartphones are far more widespread than tablets and more convenient to carry.
- Apps designed for Apple's iOS will have a consistent user experience on each of Apple's platforms because the company restricts the way consumers can use their iPhones and iPads. Android apps, in contrast, could be used in countless ways, and not just because there are hundreds of Android smartphones and tablets. If you put two people using the same app on identical Samsung Galaxy S III smartphones beside each other, the apps could look totally different, as could the way each person uses the app, Ham said. "[Users] can customize everything on Android," he said. "You can change how it works." That flexibility complicates the process of designing and coding apps for the Android.

Note: At the time this article was written, Android and iOS were the only operating systems with a significant presence in both the smartphone and tablet markets. Microsoft was attempting to catch up with Windows 8, but app development procedures for the platform were not well-established.

(Continued from page 28)

the social app Foursquare. Bruno anticipated that testing during the development process would reveal the need for changes to the app's functionality (which proved to be true), and she was willing to pay for those changes. What she was unwilling to do was start over from scratch, which would have been required for her first vendor to change functionality after coding began.

Bruno learned about the tech specs and the difference between static and dynamic coding from an IT consultant she hired while still working with the first vendor. She then pulled out of the $35,000 project for which she had paid the industry-standard 50% upfront in the form of a nonrefundable deposit.

"It was a good learning experience," she said.

Bruno was fortunate that her first vendor chose to give her a full refund. She would not be so fortunate with the second vendor, Appiction.com, an Austin, Texas-based company that boasted 55 employees and a strong track record of app development with clients including IBM, Samsung, and the state of Texas. Bruno's IT consultant vetted the company and confirmed it had the technical knowledge to handle her project. After meeting with a 12-person project team at the vendor's offices, Bruno was given a $50,000 quote to develop the app. Bruno paid $35,000 upfront because the vendor told her that paying more than half would move her project up in the development schedule, and she wanted the app delivered in time for the 2012 tax season.

That didn't happen. Within a few weeks, Appiction.com was out of business and Bruno was out $35,000. The company shut down in October 2011 and later filed for Chapter 7 bankruptcy liquidation.

"We'll never see that money again," Bruno said.

Bruno found yet another vendor, Colleen Tully, at a two-person shop in Colorado, and arranged a deal in which Tully agreed to build the app in exchange for a 15% stake in DivaCFO LLC. Tully produced the iPhone app, which Apple accepted on its first submission after a two-week vetting period. The app became available on July 12, 2012, for $4.99.

—Jeff Drew

Select the Right Stores

Perhaps nowhere is the difference between developing mobile apps for iOS and Android more pronounced than in the process of accessing a distribution channel to get the app to its intended users.

Apple requires all apps for the iPhone, iPad, and iPod Touch to be distributed exclusively through its App Store. Google, in contrast, not only offers Android apps through its Google Play store, but also allows third-party stores to offer Android apps.

The result is two diametrically opposed app store experiences. Apple controls everything in its App Store. CPAs and others who would like to distribute through the App Store must first register as an Apple developer (even if the person filing the application isn't the actual developer) and pay the associated annual fee, which is about $100, Ham said. The app must then be submitted to Apple, which thoroughly vets every app to make sure it meets the company's standards.

"Apple will make sure the app works on all platforms it's built for," Ham said.

In addition, Apple will measure the app against its current acceptable-policies list. The review process takes one to two weeks due to the high volume of submissions to the App Store. Rejections are common and can come for many reasons.

"If you build an app strictly selling stuff to your clients outside of the Apple Store or iTunes, Apple will reject such apps," Ham said.

Apple does not charge for making apps available in the App Store, but for apps that users must buy, Apple generally takes between 30% and 35% of the proceeds from each sale. In the case of DivaDocs, which sells for $4.99, Apple pockets $1.50 from each transaction, Bruno said.

Apple's strict controls do produce a couple of advantages for consumers. First, there have been no reports of malicious software, or malware, being found on any apps distributed through the App Store. Second, the App Store and iTunes enjoy high name recognition and a strong reputation for quality.

It's much quicker and easier to get an app into the Google Play store. Wright's app appeared within 24 hours of submission, he said. The CPA Exam Aid app showed up almost instantly, according to Ham.

The process won't necessarily be as easy with the hundreds of third-party Android marketplaces, which include those of Amazon, AT&T, Sprint, and Verizon, among other large players. "Each third-party marketplace has its own set of rules," Ham said. "Amazon will reject anything that smells of eBooks."

Third-party marketplaces also vary in focus. Some, such as Google Play, operate like a shopping mall, with something for everyone. Others, though, might focus on a niche.

Perhaps the biggest downside for users of the Android apps marketplace system is the risk of downloading malware. The proliferation of Android devices and third-party app markets has made the Android the top target of hackers writing malware for mobile devices.

"On Google Play, the insurance that you have is the user base themselves," Ham said. "Malware might fool the first 10 or 100 people, but as soon as someone figures it out, the app is almost instantly pulled off the marketplace. Google will pull apps and revoke licenses. Still, it does lend itself to more risk than Apple."

Exhibit 3 How Apps Should Look and Perform

CPAs pursuing the development of a mobile app should demand that the design and performance meet the following expectations:

- Transitions from page to page should be instantaneous, unless the app is streaming large amounts of data. It can be tough to spot a millisecond of lag between screens when assessing only one app, but the target audience will be able to tell if the CPA's app doesn't work quite as smoothly as other apps.
- The user experience should compare favorably to other apps used on the device(s) and operating system(s) being tested. How does the app respond to common touchscreen gestures, such as scrolling, dragging horizontally, and zooming in with a pinching motion?
- The graphics should always look crisp and clear, no matter how the user rotates them or zooms in or out. At no time should the artwork appear pixelated.
- The app should "feel right" compared to the best apps that you have on your mobile devices.

Source: Michael Ham, CPA2Biz.

ON THE QA

Before sending an app to a store, a CPA should put it through a thorough quality assurance (QA) process. All features and functions of the app should be tested, as should all operating system-specific versions of the app.

QA testing is especially important because an app can't be updated on the fly as websites can. As a result, if there is a major problem with an app, all corrections must be distributed via a new version of the app. Users who don't download the new version won't have access to the corrected code. In addition, the update process can take a great deal of time, especially at the App Store, where it can take weeks to get an update approved for distribution.

Despite the distribution hurdles, the update process should not be ignored. CPAs should not fall into the trap of paying to develop an app and then paying no attention to it after it is released to the market. A content app needs a steady supply of fresh content, for example. Otherwise, it will look neglected and outdated—not exactly a good image to convey to clients on their mobile devices.

CONCLUSION

Mobile apps offer CPAs powerful new ways to engage clients and empower employees on the devices they prefer to use. From the timely delivery of targeted content or instant access to financial tools and advice, mobile apps can provide information and interactive features that help individuals and businesses make better decisions with their money. Providing actionable intelligence clients can use aligns with the CPA's core purpose of "making sense of a changing and complex world." Still, CPAs should enter into mobile app development only if there is a compelling reason to do so and they have a clear understanding of the work involved and the risks inherent in the app development process. ❖

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How to Drive Partner Accountability and Unity

Oversight and review systems can boost firm performance.

by Dom Cingoranelli, CPA, CGMA; Jennifer Wilson; and Bill Reeb, CPA/CITP, CGMA

Partner accountability and unity are essential for accounting firms to maximize their productivity and profits. Unfortunately, partner harmony is hard to find, especially at larger firms. Consider the findings of the most recent *CPA Firm Top Issues Survey* conducted by the AICPA Private Companies Practice Section. The biennial poll of U.S. public accounting firms found that "partner accountability and unity" was the top concern at firms with 21 or more partners and the No. 2 concern at firms with 11 to 20 partners, behind only "bringing in new clients."

Partner problems are not limited to large firms. Any accounting practice with multiple owners can run into trouble with partners failing to follow through on commitments or perform to expectations. When that happens, the result is a big problem that firms of all sizes need to address.

Accounting firms seeking greater accountability, or "count-on-ability," among the partner group must first clearly define what each partner is expected to do, effectively communicate those expectations, and establish ways to measure, monitor, and reward or penalize partner performance. The responsibility for setting up the system falls on the firm's leadership team, be it a board of directors, an executive committee, an equity partner group, or something else.

Once the system is designed, the firm's leadership team must obtain buy-in from the partners and implement the plan. This article looks at the elements a partner-accountability system should contain and the steps firms can take to successfully establish such a system.

Obtain Partner Buy-In

It takes persuasion and perseverance to convince partners to accept and commit to a system that grants someone the power to hold them accountable for meeting performance expectations. Partners resist such an arrangement because they simply don't want anyone telling

Exhibit 1 Submitting to and Supporting Authority

A key attribute of an effective leader is the ability to submit—that is, to be led. To encourage this among partners, firms must establish trust-building behaviors such as ensuring that support structures (role descriptions, goals) are in place and decision authority is defined. The question for partners is this: "Once the process and support structures are defined, will you submit to them?" Submission by the partner group would allow for:

- Empowerment of the managing partner, service-line leaders, and committees.
- Increased productivity.
- Reduced stress at all levels.
- More shared focus and alignment among the partner group.
- Decisions that are made more efficiently and effectively.

them what to do. The problem with that thinking is that when CPAs are promoted to partner, they are being rewarded for accomplishments achieved while under somebody's supervision. Why then should CPAs who attain partner status go from a managed environment to one with total autonomy? The answer is simple: They shouldn't. CPAs who become partners remain very much part of a team. As such, partners should remain part of the firm's overall performance and accountability framework and yield to the authority and support of the firm's leadership (see Exhibit 1).

Firms must recognize that obtaining partner buy-in is not something they have to do just once. Partners must agree to a regular review of their goals, which should be updated to reflect changes in the partner's role and responsibilities, as well as changes in economic and market conditions. The best way to do this is to establish partner goals in individual meetings at or before the beginning of each fiscal year.

The responsibility for setting up and running these meetings belongs to the managing partner or, in larger firms, the service-line leader or department head. These leaders must understand that it is their job to help each partner hit his or her performance targets. Managing partners and other firm leaders must not abuse their role as manager of the other partners. Instead, firm leaders should act as mentors with the goal of helping each partner achieve enhanced performance, which benefits the firm as a whole.

Set Realistic and Measurable Goals With Each Partner

Partners and their supervisors should emerge from every annual goal-setting meeting with clear expectations for what the partner will produce and how the partner's productivity will be measured.

Firms can evaluate partner performance in two main areas: financial and nonfinancial measures. Financial expectations are easier to track. For example,

EXECUTIVE SUMMARY

- **A lack of partner accountability and unity ranks as the top concern of accounting firms with 21 or more partners and No. 2 among firms with 11 to 20 partners,** but partners who fail to pull their weight or align with organizational priorities can cause big trouble for firms of all sizes.
- **Accounting firms seeking greater "count-on-ability" from their partners must design a system** that establishes expectations for each partner, clearly communicates those expectations, and establishes methods to monitor, measure, and reward or penalize partner performance. The leadership team at each firm is responsible for setting up the system and obtaining partner buy-in.
- **Firm leadership must employ persuasion and persistence to convince partners to yield to a system that holds them accountable for meeting performance expectations.** This is an ongoing process best accomplished with regularly scheduled meetings between partners and their supervisor, either a managing partner or, in larger firms, a service-line or department leader.
- **Supervisors should hold individual goal-setting meetings with each partner at or near the beginning of the fiscal year.** Supervisors should work with each partner to establish realistic and measurable performance expectations. The result should be a set of goals and metrics agreed to by both parties and put into writing.
- **Firms should implement ways to monitor partner progress, the most important being check-in meetings held at least once each quarter.** Because partners must report on their progress at check-in meetings, they are more likely to make progress between meetings, increasing the chances the partner stays on track to meet his or her goals.
- **Firm leadership should establish strong rewards and consequences for partners who meet, exceed, or fall short of expectations.** Supervisors should be allotted money to give as bonuses to partners who perform exceptionally well. Sanctions for poor performance would start at private reprimands and progress through pay reductions and, ultimately, demotion or termination.

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To comment on this article or to suggest an idea for another article, contact Jeff Drew, senior editor, at jdrew@aicpa.org or 919-402-4056.

if a partner is expected to bring in $150,000 of new business, it is easy to figure out whether the partner is on pace to hit the goal or at risk of missing the target. The same holds true for other financial measures, such as:

- Profitability of client work (e.g., collections, leverage, realization, margin).
- Profitability of a department.

It is more difficult to measure partner performance on nonfinancial goals in areas such as recruiting, training and development, delegation, new service offerings, and proper client transition. Some ways to assess nonfinancial goals include:

- Using a quantitative survey tool to ascertain client satisfaction levels.
- Recording the number of leads for referral sources and prospects generated as a result of networking events the partner has attended.
- Tracking task delegation by asking partners to keep a log of all projects that they formerly handled personally but now delegate to someone else. The delegating partners also should record how they monitor and manage the delegated projects. Partners must understand that the logs will be reviewed at quarterly meetings with their supervisors (more on that in the next section).

Remember, goals should be established jointly, with agreement from each partner, and they should be one-size-fits-one, tailored to what the firm most needs and expects from each partner and designed to leverage each partner's strengths and/or minimize his or her weaknesses. At the same time, be careful not to fall into the trap of assigning higher expectations to top producers than are assigned to average performers in similar positions. Firms should reward performance greater than the expected competency from those in similar positions. Top performers earn their performance pay by exceeding average expectations, not by meeting expectations preadjusted to reflect their

Exhibit 2 Sample Partner Goals

When setting partner expectations, establish specific and measurable goals for each area of contribution. Here is a sample list.

Financial Performance

- Increase my revenue per client by XX% per client by XX/XX/XX.
- Increase my realized hourly rate from $XXX to $XXX by XX/XX/XX.
- Improve my on-time billing performance to eliminate reminders from finance as evidenced by our billing manager's assessment of this improvement by XX/XX/XX.
- Increase the profit contribution from the service line that I manage to XX% by XX/XX/XX.

Business Development

- Bring in X new audit clients from contacts generated by me worth $XX,XXX by XX/XX/XX.
- Refer $XXK in new business for our SERVICE LINE by XX/XX/XX.
- Conduct an average of four referral source or prospect meetings per month, or 48 meetings in total, by XX/XX/XX; track these meetings and their outcomes/next steps in our CRM or in Excel.
- Increase revenue per client for my top 10 clients by XX% by XX/XX/XX.

Client Management

- Hold strategic client account planning meetings for my top 15 clients, completing three specific actions or outcomes determined for each client by XX/XX/XX.
- Make two additional C-level, board member, or key service-provider contacts for each of my top five clients by XX/XX/XX.
- Transition 30 smaller corporate or personal tax clients to PERSON'S NAME or OUT OF OUR PRACTICE by XX/XX/XX.
- Develop the client portion of my succession plan by identifying to whom I will transition each client and by when and reviewing that plan with my department head by XX/XX/XX.

People Development

- Develop procedures and best practices associated with SPECIALTY TAX SERVICE LINE that are approved by the Tax Department Head and rolled out in web-based training to all Tax staff by XX/XX/XX.
- Mentor PERSON'S NAME to prepare her to move to the role of manager, including taking her to two referral source meetings and two sales meetings and including her in two performance conversations with staff by XX/XX/XX.
- Recruit a senior audit manager into our group by XX/XX/XX.

Leadership

- Develop a written plan to develop or increase our penetration in the X market and gain approval from PERSON by XX/XX/XX.
- Improve my listening skills with my team members as measured by an upstream listening assessment to be conducted by XX/XX/XX and then a check-in survey conducted on YY/YY/YY.

Exhibit 3 Ideas for Check-In Meetings

- Partners should share their status against their goals with their supervisor and in departmental, office, or firmwide partner meetings.
- Check-in meetings should take place at least once a quarter.
- In the meetings:
  - Share roadblocks and breakthroughs, and communicate both appreciation and disappointment.
  - Engage in "straight talk" about unmet commitments.
  - Don't allow for fuzzy language when gaining new commitments related to goals that are off track (e.g., "I'll try").
- Identify any needs or requests the partner has to achieve his or her goals.
- Have each partner write a brief recap for all monitoring meetings to ensure clarity on decisions made and actions assigned. The recaps should include:
  - Which goals are on track.
  - Which goals are off track and who owns which actions to address these.
  - When those actions will be complete.
  - Any other decisions that were made and, if a decision wasn't reached, who is taking the lead to make sure a decision is made after the meeting.
  - When the next status reporting meeting will occur.

Exhibit 4 Compensation Committee Considerations

A compensation committee makes sense for some firms. If you are considering one at your firm, remember that a compensation committee, if formed, is a committee of the board of directors (or executive committee), not a committee that has unique dictatorial authority. Compensation committees should be charged with:

- Developing the firm's compensation philosophy or framework, subject to approval by the board and/or equity partner group.
- Recommending base salaries or guaranteed portions of salaries involved, including any year-over-year adjustments, whether up or down.
- Establishing objective metrics and firmwide incentives that support the accomplishment of the firm's strategic plan.

exceptional abilities. Each partner's annual goals should be put in writing. For an example, see Exhibit 2.

Provide Continual Communication and Feedback

Once the goals are established and the partner takes ownership of them, firms should set up monitoring systems, processes, and specific checkpoints to ensure the partner stays on track. Unfortunately, most firms implement performance systems that are visited only twice a year—when the goals are set and when the final performance assessment is completed. The lack of regular communication between partners and their supervisors often results in disappointing performance.

We recommend simple, frequent monitoring techniques including, but not limited to, quick meetings to review progress, high-level written status summaries, to-do lists, and reports generated by practice management systems.

Managing partners and other supervisors can drive performance by holding check-in meetings where partners report on the progress they have made toward reaching their goals. When partners know they will have to report on their progress, they are more likely to actually make progress. These meetings should take place at least once a quarter. During the meetings, partners and their supervisors can discuss the status of each goal, looking at both the measure and the "quality" behind the performance. For instance, on the aforementioned delegation goal, the supervisor and partner would review the task-tracking log to verify whether the partner has properly monitored delegated work or "dumped" it in the hopes that everything would work out. The partner also can discuss how the new owner of each delegated task is performing and so on. For other ideas on how to make the most of check-in meetings, see Exhibit 3.

Establish Rewards and Consequences

Effective accountability systems reward partners for adhering to processes and procedures, living up to their roles and responsibilities, and implementing the firm's strategy. Such systems also impose sanctions when partners do not perform up to expectations. Rewards can take the form of public praise, financial stimulus (incentive pay), and promotions (from nonequity to equity partner, being appointed to lead practice areas or serve on leadership committees, etc.). Sanctions may include private reprimands, reductions in pay, greater reductions in pay, and, ultimately, demotion or termination.

Firms can best promote partner accountability by allotting the partners'

supervisors—the managing partner, service-line leaders, or department heads—a pool of money that each supervisor can award, as he or she sees fit, to partners who achieve individual goals. The amount of performance pay varies, but firms should offer sums large enough to motivate partners to meet their goals. The design of financial reward systems can be delegated (see Exhibit 4), but firm boards or leadership groups must have final say on approval.

Firms often resist setting up a performance pay system for partners, because someone in the past held too much control over owner compensation, and that power was perceived to have been abused. Proper design of the reward system should mitigate those concerns.

Conclusion

It is neither quick nor easy to devise and implement a partner accountability program, but firms that do so establish an environment in which partners who contribute significantly are rewarded (and happy) and those who contribute less are clear on what they can do better or differently in the future. Such an environment provides fertile ground for the seeds of partner unity and accountability to blossom into a flourishing firm, one where shared goals and a stronger spirit of teamwork reap a harvest of heightened performance, higher job satisfaction, and healthy profits. ❖

> CPAs who become partners remain very much part of a team and should remain part of the firm's overall performance and accountability framework.

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Websites

- PCPS Partner Accountability Guide (available to PCPS members only), tinyurl.com/Partner-Accountability-Guide
- 2011 PCPS CPA Firm Top Issues Survey, tinyurl.com/top-firm-issues
- 2012 PCPS Succession Survey report, tinyurl.com/cpjdgqu

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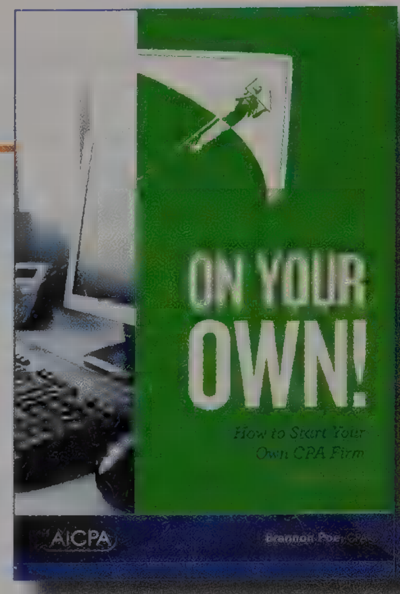

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Derived from On Your Own! How to Start Your Own CPA Firm, *Second Edition by Brannon Poe.*

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RECOMMENDED CPE CREDIT: DVD/Text/Manual — 33.5
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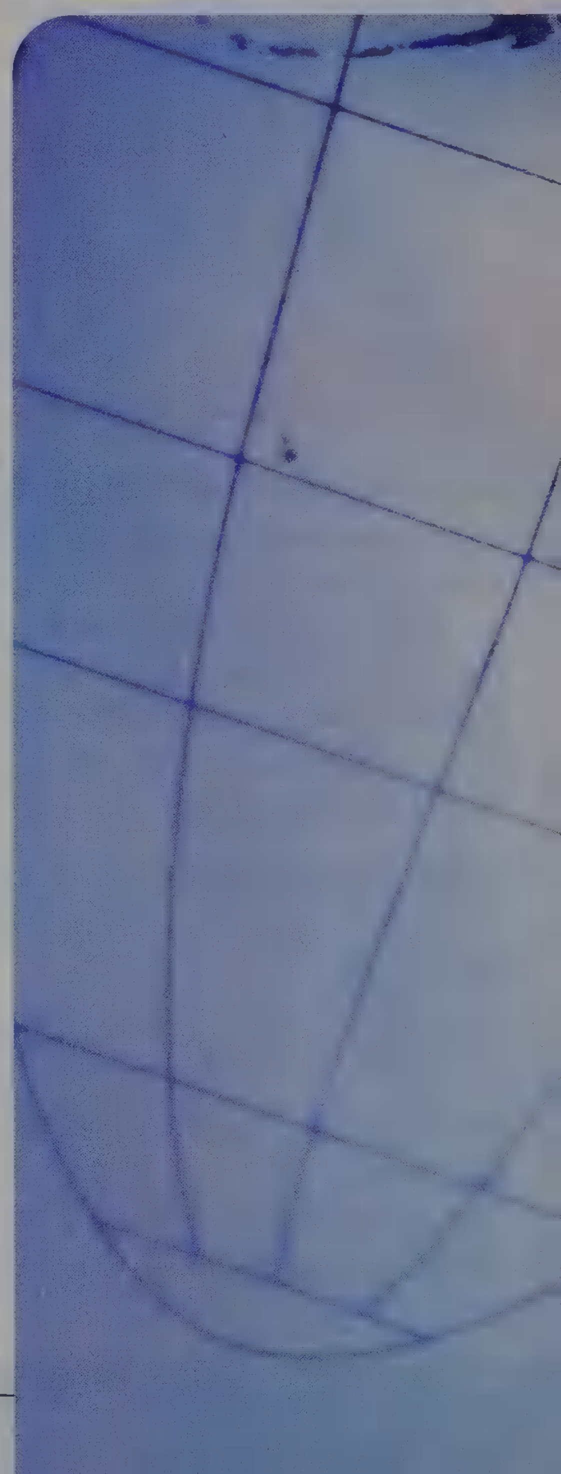
How to Do Business Abroad

A rising number of small and midsize companies go international.

by Sabine Vollmer



Infragistics is a 21st-century pioneer. The midsize New Jersey software developer has built its business by expanding into emerging markets—wherever it could find sales potential and outstanding software development talent. "If there's a strategic business opportunity, if it's kosher, we'll go there," said Chris Rogers, CPA, CFO of Infragistics, which was founded in 1989 and today has about 350 employees on five continents.

In the not-too-distant past, being a multinational company was synonymous with being a large company. Corporate giants such as Wal-Mart Stores, United Parcel Service, General Electric, and International Paper—multinationals that have tens of thousands of employees; billions in annual revenue; and generations' worth of experience in selling, setting up offices, and establishing production operations overseas—have loomed large among the U.S. companies that own equity in a foreign enterprise.

What has changed, though, is that more small and midsize companies such as Infragistics are venturing abroad in search of talent and leading-edge technology at a lower cost than in advanced economies in North America or Europe and establishing a foothold in markets with developing middle classes.

What they're encountering in Asia, Latin America, the Middle East, and Africa are unfamiliar customs and laws, which, if not handled carefully, can pose significant risks.

"As soon as you move products or services across borders, the game really changes," said Sean Lager, CPA, a partner at Atlanta accounting firm Frazier & Deeter who advises companies interested in getting an international foothold.

Infragistics knows this well. The company started establishing its international footprint about a decade ago. At the time, the company was struggling financially.

Before the Sept. 11, 2001, terrorist attacks, most of Infragistics's cash went into building new technology. When the U.S. economy slowed and the company's business dropped abruptly following 9/11, Infragistics's financial situation deteriorated, leading to a weak balance sheet, Rogers said.

To get back on track, the company restructured and looked abroad.

"International operations have given us access to foreign labor markets at reduced cost while also allowing us to build in zone support for our global customer base," Rogers said.

PHOTO BY COMSTOCK/THINKSTOCK

In December 2011, Infragistics bought a startup with a dozen software developers in Uruguay, an acquisition that helped the company jump-start software development for Apple products. The company also has research and development centers in Japan, Bulgaria, and the United States and sales and marketing offices in Germany, India, and Australia.

With each expansion, the company has confronted new tax laws; repatriation of cash; intellectual property (IP) theft; currency fluctuations; and labor law and regulatory issues.

Among the myriad issues that need to be navigated, three—taxes, fraud, and talent—have come up repeatedly in emerging markets, according to CPAs who work for multinationals and consultants who advise companies doing business internationally. Rogers and several others offered tips and lessons learned on each of the three issues from doing business in emerging markets.

THE TALENT SEARCH

Finding top accounting, financial, and IT talent in emerging markets can be more difficult than in the United States, said Steve Saah, director of permanent placement services in professional staffing firm Robert Half's Washington office.

The World Economic Forum reported that worldwide an estimated 10 million jobs in manufacturing cannot be filled because of a growing skills gap. The shortage was most acute in Asia Pacific countries last year, according to a Deloitte global poll of more than 350 senior executives at companies with at least $500 million in sales.

U.S. companies doing business overseas for the first time also frequently struggle with the labor laws, business etiquette, and culture they encounter in the new markets, said Tony Cherbak, COO of Resources Global Professionals, Irvine, Calif.-based professional services consultants that help clients recruit employees overseas.

For example, a U.S. company that is used to benefit costs that add 25% to 30% to an employee's pay in the United States

will find that benefit costs double an employee's pay in Brazil, Cherbak said. And firing a Brazilian employee is much more difficult and expensive than letting a U.S. employee go.

Developing a game plan and visiting the country are critical steps to avoid recruitment regrets. When looking into starting operations in Uruguay, Infragistics learned about the intricacies of the country's labor laws.

"It doesn't take long for the lower-cost employee in Uruguay to not be a lower-cost solution," Rogers said. His solution? Hire them as consultants.

"If [the consultant] is a degreed professional, you hire them as a single-member consulting company, and they bill you with VAT that is reclaimed against the government," Rogers said.

Figure out which functions need to be in the emerging market. First, the CFO and his or her team should assess the size of the accounting and finance infrastructure that is needed in the new market and how the overseas functions should report to the U.S. parent company. The talent pool in the country the company plans to expand into and the industry the company is in will influence this assessment.

Also, renting a large office for lots of employees in a particular location can be costlier than expected, Cherbak said. Office space in Brazil, China, and India is not necessarily cheap. "Mumbai is just as expensive as New York City," he said.

Identify skilled local talent. A company should explore all sourcing options and figure out what is most cost-effective—whether that is hiring a recruiter or a temporary staffing firm, holding an open house, or placing ads in the local newspaper, Saah said.

Peers and local vendors can be good resources to vet job candidates, he added.

U.S. companies doing business overseas for the first time struggle with the labor laws, business etiquette, and culture they encounter in the new markets.

Global consulting firm Booz & Co. recommends in a talent management report that companies partner with other companies, even competitors, to custom-build talent through university partnerships; tap nontraditional talent sources, such as crowdsourcing; and embrace local norms, behaviors, mindsets, and commitments in markets abroad.

Avoiding bad hires. Taking time to get to know a candidate in an extensive interview process is a good way to avoid bad hires, Cherbak said.

The job candidate who on paper looked like a good fit for the managing director position of Resources Global Professionals's Shanghai office first had to go through interviews with the firm's employees in China and about two weeks later flew to the U.S. headquarters for a day of interviews with a handful of people in Irvine, Calif., Cherbak said. The candidate was eventually hired and has been with the firm for about two years.

Infragistics also follows a team interview process, Rogers said. "The higher up the chain you go, the more drawn out the process usually is."

Fraud Can Be a Pitfall

Common business practices in some countries may collide with U.S. laws, such as the Foreign Corrupt Practices Act (FCPA). Other risks include internet fraud, IP theft, imposters, and even money laundering. Recent research underscores the trend:

- More than one-third of CFOs from around the globe responding to an Ernst & Young poll in 2011 and 2012 reported that bribery and corrupt practices occur frequently in their countries. Corruption seems to be particularly widespread in Brazil, the Czech Republic, Indonesia, Mexico, and Turkey, E&Y found.
- In 2011, 26 enforcement actions were brought against companies under the FCPA, according to an analysis by U.S. law firm WilmerHale. Most involved third-party sales agents or intermediaries. High-risk markets included China, India, Thailand, South Korea, and Mexico.
- Respondents to a recent survey by the Chartered Global Management Accountant (CGMA) joint venture between the AICPA and Chartered Institute of Management Accountants (CIMA) showed regional differences

EXECUTIVE SUMMARY

- **Small and midsize companies are increasingly venturing abroad** in search of skilled talent and leading-edge technology at a lower cost than in advanced economies and a foothold in markets with a developing middle class.
- **The biggest risks of doing business in emerging markets** involve taxes, fraud, and talent recruitment.
- **Becoming familiar with the emerging market, its laws, customs, and culture** is as important as calculating the costs, revenue, and profits of a planned expansion.
- **Internal controls, independent audits, and a whistleblower hotline** are powerful fraud busters, but so is professional skepticism. U.S. companies doing business abroad must also be vigilant about common practices in emerging markets that may collide with the Foreign Corrupt Practices Act.
- **To find local talent in emerging markets,** small and midsize companies can make up for their lack of resources by tapping peers and local vendors, partnering with universities, or crowdsourcing.

__Sabine Vollmer__ is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact her at svollmer@aicpa.org or 919-402-2304.

in pressures to act unethically during an economic downturn. More than half of the respondents from India, Malaysia, Pakistan, Sri Lanka, and Zambia said they felt some pressure to compromise their organizations' ethical standards. The United States and the U.K. reported the lowest pressure—18% each.

Protection of IP can be weaker in other countries than in the United States, exposing companies like Infragistics to IP theft. "What we try to do is ensure that the innovation is put to market as fast as possible with quality, so that we can generate profits from the innovation until a competitor 'develops' that feature as well," Rogers said.

Multinational giants usually have established protocols and dedicated resources to ferret out fraud, said David Stulb, global leader for Fraud Investigation & Dispute Services at Ernst & Young. But small and midsize companies tend to be at a disadvantage because they work with smaller budgets and fewer people.

Having senior management with experience in the business and cultural climates of overseas markets is an important asset for small and midsize companies, said Lager at Frazier & Deeter.

Also, a CGMA fraud risk management report recommends, for example, establishing a whistleblower hotline, training employees in procurement and finance to detect warning signs, and introducing fraud and ethics policy statements.

"The likelihood of getting burned in a market you don't know is high," said Nigel Iyer, a fraud expert and former chartered accountant in the U.K. who works with CIMA.

But detecting the early red flags of fraud can be less daunting than it looks.

Turn on your professional skepticism. Iyer recommends companies do their homework. Verify identities, addresses, and phone numbers of potential customers, suppliers, advisers, and partners. Public company registries and telephone books are online in many emerging markets.

With "a healthy cynicism, you're more likely to find red flags," he said. But "attention to details is key."

For example, Iyer said, he recently came across an Indian supplier and business partner with a nice office and a multiyear history on its website. But the actual company had been registered as a business just two months earlier, he said. All it took to find that out was a company registration check on a ministry website, Iyer said. Sometimes, a phone call is required to a regional registry to find a company's name.

An offshore account or company address in a tax haven that does not match a company's location may also be a red flag, he said.

In his investigations, Iyer has come across offshore accounts that were used to provide corporate slush funds for bribes, to pay secret salary bonuses to top managers, and to invoice and overcharge suppliers.

"Don't be fooled by the shortness of the international blacklists you may have heard about," Iyer co-wrote with another fraud expert for the Tax Justice Network. "The international community (and bodies such as the OECD [Organisation for Economic Co-operation and Development]) have understandably focused on aspects like the drugs, dictators, and terrorists but not, in our opinion, on typical frauds."

Kick the tires a little harder. Due diligence should include an analysis of multiple years of financials and robust interviews of acquisition players and peer groups, Stulb said.

Also, professional organizations, chambers of commerce, and even embassies can help find trusted local partners for U.S. companies.

Train and audit. Once a company is in an emerging market, training and regular audits are critical to keeping fraud at bay.

Stulb recommended at least one annual internal audit visit from somebody independent of the local entity. But audits can be challenging for somebody not familiar with the market, he said. "It's tough for somebody used to U.S. reviews to put him on an airplane to Indonesia."

Hotlines are also considered effective to detect fraud. A 2012 report by the Association of Certified Fraud Examiners found that fraud is most commonly detected through employee tips, and organizations that have antifraud training programs for employees, managers, and executives experience less costly losses and shorter occurrences of fraud.

Respondents from business and industry in an AICPA survey, meanwhile, said they are using general internal controls, screening of new employees, division of responsibilities, appropriate oversight, physical controls, and computer-based controls to prevent fraud.

At Infragistics, Rogers said he relies on well-functioning internal controls and employees he hires because they are smart and capable. In some locations, he said, he has learned to be creative, to separate duties, and to make nonfinance employees responsible for some finance functions.

> Common business practices in some countries may collide with U.S. laws, such as the Foreign Corrupt Practices Act.

Plan for Taxes First

Tax issues, from bilateral tax treaties to indirect taxes, drive how a company's overseas operations should be set up, how a company's products should be priced, and how a company can manage its cash.

The list of tax issues a company needs to address is long—too long to get into all of them here. But some are on the rise internationally, according to a 2012 survey conducted by Taxand, a global organization that advises companies on tax issues. The survey of CFOs of large multinational companies in about 30 countries showed an increase in transfer-pricing disputes and rising value-added taxes (VATs). More than a dozen countries established, increased, or planned to increase VAT rates

in 2012, according to data compiled by The TMF Group.

Other tax issues are fundamental:

Plan to get into and out of a new market. Planning the operational structure of an international business expansion should include the possibility that the overseas expansion generates losses, will be transferred in an intercompany restructuring, or will be sold, said Blake Vickers, CPA, CGMA, international tax manager at KBR, a Houston-based global engineering company. Tax treaties between countries make for important ingredients in exit strategies, said Vickers, who also is a member of the AICPA International Tax Technical Resource Panel.

A U.S. company planning a subsidiary in India, for example, may want to invest through a subsidiary in Singapore rather than directly into India, he said. If the subsidiary is sold or transferred in an intercompany restructuring later, the U.S. parent company should owe no capital gains taxes in India because of the current bilateral agreement between India and Singapore and Singapore's lack of a capital gains tax, Vickers said.

In Vickers's scenario, the exit strategy would determine the operational structure of the overseas subsidiary before the subsidiary even opens.

At Infragistics, Rogers said he deals with this by hiring a good local tax firm to prepare a comprehensive tax primer based on Infragistics's business setup.

Understand currency controls. Knowing how to repatriate cash generated by overseas operations is important for a company's cash management. Most emerging countries have some type of transfer-pricing regulation, said Ernesto Perez, managing director at New York-based consultants Alvarez & Marsal Taxand, and U.S. companies interested in doing business in those countries need to understand the rules and the enforcement.

Some countries also have currency controls that further strain a company's cash management. China, for example, limits dividend payments to one a year, Perez said. This can lead to cash being trapped in China and cash management timing issues.

But there are ways around the annually allowed dividend payment, he said. A U.S. company could, for example, charge its Chinese operations royalties or a fee for management services.

Professional organizations, chambers of commerce, and even embassies can help find trusted local partners for U.S. companies.

Be aware of the risk of changing tax rule interpretations in emerging markets. While legislation may change tax rules in the United States and Europe, companies can generally rely on tax authorities to enforce the rules in an evenhanded manner, Vickers said.

In emerging countries—especially those with weak or unstable governments—the tax laws themselves may not change, but the interpretation and enforcement often do, Vickers said. For example, paperwork that was not required one year is, without warning, required the following year, or tax assessments may not correctly flow from taxable income, he said. In countries that are unstable or emerging, tax authorities can be arbitrary. ❖

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AICPA RESOURCES

JofA articles

- "Treasury Basics for an Overseas Expansion," Sept. 2012, page 16
- "Business Basics in Brazil," Nov. 2011, page 34
- "PCAOB: Be On the Lookout for Fraud in Emerging Markets," Oct. 3, 2011, tinyurl.com/ccjpmml
- "Lessons on Managing Risk in Emerging Markets," July 28, 2011, tinyurl.com/8pfddk7
- "Business Basics in China," May 2011, page 42

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***CGMA Magazine* articles**

- "Companies Do Poorly Managing Corruption Risks in Emerging Markets," Nov. 1, 2012, tinyurl.com/cpquoua
- "How Corporate Expansion Strategies Can Target Emerging-Growth Powerhouses," Aug. 27, 2012, tinyurl.com/d8vsvou
- "Global Consultants Identify Top Tax Challenges for Multinationals and Offer Advice," July 30, 2012, tinyurl.com/bsbcxw7
- "Emerging Market Multinationals Must Grow Leaders From Within," July 20, 2012, tinyurl.com/bu4h7lb
- "Pay to Play? Survey Shows Increased Risks of Bribery, Corruption," May 26, 2012, tinyurl.com/bnv85bc
- "Succeeding in the CIVETS," Jan. 31, 2012, tinyurl.com/8cywfgh

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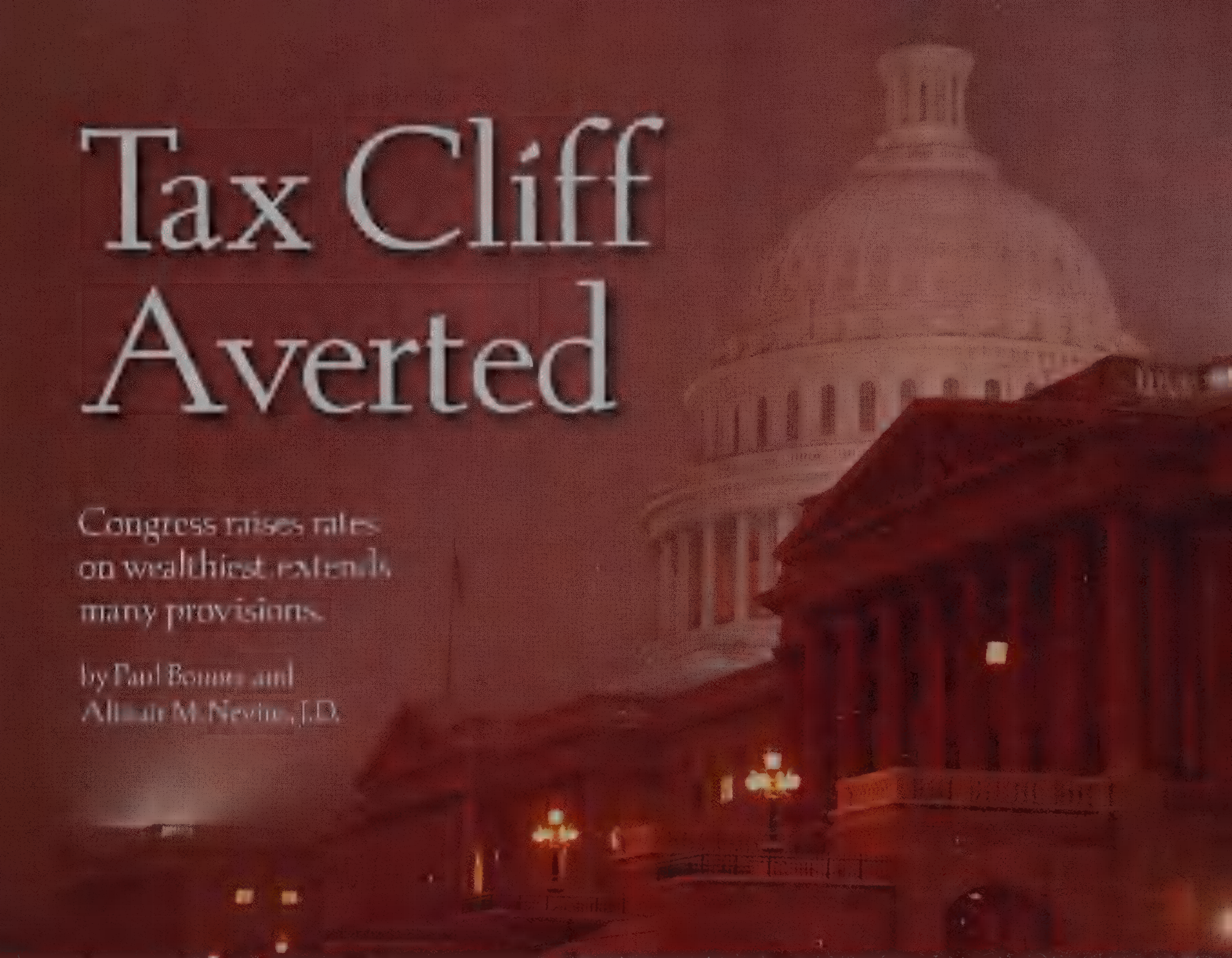

Tax Cliff Averted

Congress raises rates on wealthiest, extends many provisions.

by Paul Bonner and Alistair M. Nevius, J.D.

Pulling back from the "fiscal cliff" at the 13th hour, Congress on New Year's Day preserved most of the George W. Bush-era tax cuts and extended many other lapsed tax provisions.

The new law brings a multitude of changes affecting both 2012 returns and, for the new year, tax planning, withholding, and estimated tax payments, prompting many considerations for CPAs and their clients concerning implementation of the new measures. In addition, new taxes and provisions enacted in 2010 by health care reform legislation took effect Jan. 1.

> ***Editor's note:*** An updated version of the *JofA*'s Filing Season Quick Guide for tax year 2012, reflecting changes made by the American Taxpayer Relief Act, is available for download at tinyurl.com/b2zyjp7.

Shortly before 2 a.m. on Jan. 1, the Senate passed by a vote of 89–8 the American Taxpayer Relief Act of 2012, H.R. 8, which embodied an agreement that had been hammered out over the preceding two days between Vice President Joe Biden and Senate Minority Leader Sen. Mitch McConnell, R-Ky. The House of Representatives approved the bill by a vote of 257–167 late that evening, after plans to amend the bill to include spending cuts were abandoned. President Barack Obama signed the bill Jan. 2.

"The AICPA is pleased that an agreement has been signed into law," said Edward Karl, vice president–Tax for the AICPA. "Besides allowing the IRS and tax software providers to implement critically needed administrative plans and updates for the current tax season, the act should now enable taxpayers to make informed decisions and businesses to get on with their long-term tax and cash flow planning. The AICPA has been working with our members to help them understand and implement these changes in the tax law. We also will continue to closely follow tax-related developments as the next chapter in the legislative saga unfolds."

The act's impact on tax season was not immediately known. The IRS issued a statement on Jan. 2 saying that it was assessing what effect the act would have. The IRS released updated withholding tables on Jan. 3.

With some modifications targeting the wealthiest Americans with higher taxes, the act permanently extends provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, P.L. 107-16 (EGTRRA), and Jobs and Growth Tax Relief Reconciliation Act of 2003, P.L. 108-27 (JGTRRA). It also permanently takes care of Congress's perennial job of "patching" the alternative minimum tax (AMT). It temporarily extends many other tax provisions that briefly lapsed at midnight on Dec. 31, 2012, and others that had expired a year earlier.

The act's nontax features include one-year extensions of emergency unemployment insurance and agricultural programs and yet another "doc fix" postponement of automatic cuts in Medicare payments to physicians. In addition, it delays until March a broad range of automatic federal spending cuts known as sequestration that otherwise would have begun immediately.

Among the tax items not addressed by the act was the temporary lower 4.2% rate for employees' portion of the Social Security payroll tax, which was not extended and has reverted to 6.2%. Certain taxpayers also face higher taxes starting in 2013 as a result of provisions also described below that were enacted by the 2010 health care reform legislation.

Here are the act's main tax features:

Individual Income Tax Rates

All the individual marginal tax rates under EGTRRA and JGTRRA are retained (10%, 15%, 25%, 28%, 33%, and 35%). A new top rate of 39.6% is imposed on taxable income over $400,000 for single filers, $425,000 for head-of-household filers, and $450,000 for married taxpayers filing jointly ($225,000 for each married spouse filing separately).

Phaseout of Itemized Deductions and Personal Exemptions

The personal exemptions and itemized deductions phaseout is reinstated at a higher threshold of $250,000 for single taxpayers, $275,000 for heads of household, and $300,000 for married taxpayers filing jointly.

Capital Gains and Dividends

A 20% rate applies to capital gains and dividends for individuals above the top income tax bracket threshold; the 15% rate is retained for taxpayers in the middle brackets. The zero rate is retained for taxpayers in the 10% and 15% brackets.

Alternative Minimum Tax

The exemption amount for the AMT on individuals is permanently indexed for inflation. For 2012, the exemption amounts are $78,750 for married taxpayers filing jointly and $50,600 for single filers. Relief from AMT for nonrefundable credits is retained.

Estate and Gift Tax

The estate and gift tax exclusion amount is retained at $5 million indexed for inflation ($5.12 million in 2012), but the top tax rate increases from 35% to 40% for decedents dying, gifts made, and generation-skipping transfers made on or after Jan. 1, 2013. The estate tax "portability" election, under which, if an election is made, the surviving spouse's exemption amount is increased by the deceased spouse's unused exemption amount, is made permanent by the act.

In-Plan Roth Rollovers

The act changes the rules governing in-plan rollovers from Sec. 401(k), 403(b), or 457(b) plans to a Roth 401(k) plan, allowing these rollovers to be made without a distribution. Under a special rule (new subparagraph (E) added to Sec. 402A(c)(4)), participants may transfer any amount not otherwise distributable under the plan to the designated Roth account as a qualified rollover contribution.

Permanent Extensions

Various temporary tax provisions enacted as part of EGTRRA are made permanent. These include:

- Marriage penalty relief (i.e., the increased size of the 15% rate bracket (Sec. 1(f)(8)) and increased standard deduction for married taxpayers filing jointly (Sec. 63(c)(2));
- The liberalized child and dependent care credit rules (allowing the credit to be calculated based on up to $3,000 of expenses for one dependent or up to $6,000 for more than one) (Sec. 21);
- The exclusion for National Health Service Corps and Armed Forces Health Professions scholarships (Sec. 117(c)(2));
- The exclusion for employer-provided educational assistance (Sec. 127);
- The enhanced rules for student loan deductions introduced by EGTRRA (Sec. 221);
- The higher contribution amount and other EGTRRA changes to Coverdell education savings accounts (Sec. 530);
- The employer-provided child care credit (Sec. 45F);

- Special treatment of tax-exempt bonds for education facilities (Sec 142(a)(13));
- Repeal of the collapsible corporation rules (Sec. 341);
- Special rates for accumulated earnings tax and personal holding company tax (Secs. 531 and 541);
- Expanded adoption credit (Sec. 23) and adoption-assistance program (Sec. 137) amounts; and
- Modified tax treatment for electing Alaska Native Settlement Trusts (Sec. 646).

Individual Credits Expired at the End of 2012

The American opportunity tax credit for qualified tuition and other expenses of higher education is extended through 2017. Other credits and items from the American Recovery and Reinvestment Act of 2009, P.L. 111-5, that are extended for the same five-year period include enhanced provisions of the child tax credit under Sec. 24(d) and the earned income tax credit under Sec. 32(b). In addition, the bill permanently extends a rule excluding from taxable income refunds from certain federal and federally assisted programs (Sec. 6409).

Individual Provisions Expired at the End of 2011

The act also extends through 2013 a number of temporary individual tax provisions, most of which expired at the end of 2011:

- Deduction for certain expenses of elementary and secondary schoolteachers (Sec. 62);
- Exclusion from gross income of discharge of qualified principal residence indebtedness (Sec. 108);
- Parity for exclusion from income for employer-provided mass transit and parking benefits (Sec. 132(f));
- Mortgage insurance premiums treated as qualified residence interest (Sec. 163(h));
- Deduction of state and local general sales taxes (Sec. 164(b));
- Special rule for contributions of capital gain real property made for conservation purposes (Sec. 170(b));
- Above-the-line deduction for qualified tuition and related expenses (Sec. 222); and
- Tax-free distributions from individual retirement plans for charitable purposes (Sec. 408(d)).

Business Tax Extenders

The act also extends many business tax credits and other provisions. Notably, it extends through 2013 and modifies the Sec. 41 credit for increasing research and development activities, which expired at the end of 2011. The credit is modified to allow partial inclusion in qualified research expenses and gross receipts those of an acquired trade or business or major portion of one. The increased expensing amounts from 2011 under Sec. 179 are extended through 2013. The availability of an additional 50% first-year bonus depreciation (Sec. 168(k)) is also extended for one year by the act. It now generally applies to property placed in service before Jan. 1, 2014 (Jan. 1, 2015, for certain property with longer production periods).

Other business provisions extended through 2013, and in some cases modified, are:

- Temporary minimum low-income tax credit rate for non-federally subsidized new buildings (Sec. 42);
- Housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds (Section 3005 of the Housing Assistance Tax Act of 2008);
- Indian employment tax credit (Sec. 45A);
- New markets tax credit (Sec. 45D);
- Railroad track maintenance credit (Sec. 45G);
- Mine rescue team training credit (Sec. 45N);
- Employer wage credit for employees who are active duty members of the uniformed services (Sec. 45P);
- Work opportunity tax credit (Sec. 51);
- Qualified zone academy bonds (Sec. 54E);
- Fifteen-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (Sec. 168(e));
- Accelerated depreciation for business property on an Indian reservation (Sec. 168(j));
- Enhanced charitable deduction for contributions of food inventory (Sec. 170(e));
- Election to expense mine safety equipment (Sec. 179E);
- Special expensing rules for certain film and television productions (Sec. 181);
- Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (Sec. 199(d));
- Modification of tax treatment of certain payments to controlling exempt organizations (Sec. 512(b));
- Treatment of certain dividends of regulated investment companies (Sec. 871(k));
- Regulated investment company qualified investment entity treatment under the Foreign Investment in Real Property Tax Act (Sec. 897(h));
- Extension of subpart F exception for active financing income (Sec. 953(e));
- Lookthrough treatment of payments between related controlled foreign corporations under foreign personal holding company rules (Sec. 954);
- Temporary exclusion of 100% of gain on certain small business stock (Sec. 1202);
- Basis adjustment to stock of S corporations making charitable contributions of property (Sec. 1367);
- Reduction in S corporation recognition period for built-in gains tax (Sec. 1374(d));
- Empowerment zone tax incentives (Sec. 1391);
- Tax-exempt financing for New York Liberty Zone (Sec. 1400L);
- Temporary increase in limit on cover-over of rum excise taxes to Puerto Rico and the Virgin Islands (Sec. 7652(f)); and
- American Samoa economic development credit (Section 119 of the Tax Relief and Health Care Act of 2006, P.L. 109-432, as modified).

Energy Tax Extenders

The act also extends through 2013, and in some cases modifies, a number of energy credits and provisions, most of which expired at the end of 2011:

- Credit for energy-efficient existing homes (Sec. 25C);

- Credit for alternative fuel vehicle refueling property (Sec. 30C);
- Credit for two- or three-wheeled plug-in electric vehicles (Sec. 30D);
- Cellulosic biofuel producer credit (Sec. 40(b), as modified);
- Incentives for biodiesel and renewable diesel (Sec. 40A);
- Production credit for Indian coal facilities placed in service before 2009 (Sec. 45(e)) (extended to an eight-year period);
- Credits with respect to facilities producing energy from certain renewable resources (Sec. 45(d), as modified);
- Credit for energy-efficient new homes (Sec. 45L);
- Credit for energy-efficient appliances (Sec. 45M);
- Special allowance for cellulosic biofuel plant property (Sec. 168(l), as modified);
- Special rule for sales or dispositions to implement Federal Energy Regulatory Commission or state electric restructuring policy for qualified electric utilities (Sec. 451); and
- Alternative fuels excise tax credits (Sec. 6426).

Foreign Provisions

The IRS's authority under Sec. 1445(e)(1) to apply a withholding tax to gains on the disposition of U.S. real property interests by partnerships, trusts, or estates that are passed through to partners or beneficiaries that are foreign persons is made permanent, and the amount is increased to 20%.

New Taxes Under 2010 Health Care Reform

Apart from the American Taxpayer Relief Act's provisions, some new taxes and other provisions also took effect Jan. 1 as a result of 2010's health care reform legislation.

Additional hospital insurance tax on high-income taxpayers. The employee portion of the hospital insurance part of Federal Insurance Contributions Act tax (FICA), normally 1.45% of covered wages, is increased by 0.9% on wages that exceed a threshold amount. The additional tax is imposed on the combined wages of both the taxpayer and the taxpayer's spouse in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

For self-employed taxpayers, the same additional hospital insurance tax applies to the hospital insurance portion of Self-Employment Contributions Act (SECA) tax on self-employment income in excess of the threshold amount.

Medicare tax on investment income. Starting Jan. 1, Sec. 1411 imposes a tax on individuals equal to 3.8% of the lesser of the individual's net investment income for the year or the amount the individual's modified adjusted gross income (AGI) exceeds a threshold amount. For estates and trusts, the tax equals 3.8% of the lesser of undistributed net investment income or AGI over the dollar amount at which the highest trust and estate tax bracket begins.

For married individuals filing a joint return and surviving spouses, the threshold amount is $250,000; for married taxpayers filing separately, it is $125,000; and, for other individuals, it is $200,000.

Net investment income means investment income reduced by deductions properly allocable to that income. Investment income includes income from interest, dividends, annuities, royalties, and rents, and net gain from disposition of property, other than such income derived in the ordinary course of a trade or business. However, income from a trade or business that is a passive activity and from a trade or business of trading in financial instruments or commodities is included in investment income.

Medical care itemized deduction threshold. The threshold for the itemized deduction for unreimbursed medical expenses has increased from 7.5% of AGI to 10% of AGI for regular income tax purposes. This is effective for all individuals, except, in the years 2013–2016, if either the taxpayer or the taxpayer's spouse has turned 65 before the end of the tax year, the increased threshold does not apply and the threshold remains at 7.5% of AGI.

Flexible spending arrangement. Effective for cafeteria plan years beginning after Dec. 31, 2012, the maximum amount of salary reduction contributions that an employee may elect to have made to a health flexible spending arrangement for any plan year is $2,500. ❖

Paul Bonner *is a* JofA *senior editor, and* ***Alistair M. Nevius*** *is the* JofA*'s editor-in-chief, tax. To comment on this article or to suggest an idea for another article, contact them at pbonner@aicpa.org and anevius@aicpa.org or 919-402-4434 and 919-402-4052.*

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JofA articles

- "Tax and Fiscal Cliff Resources," journalofaccountancy.com/News/Taxmageddon.htm
- "Year-End Tax Planning: Preparing for the Tax Cliff," Dec. 2012, page 48
- "Facing the Tax Cliff," Nov. 2012, page 48

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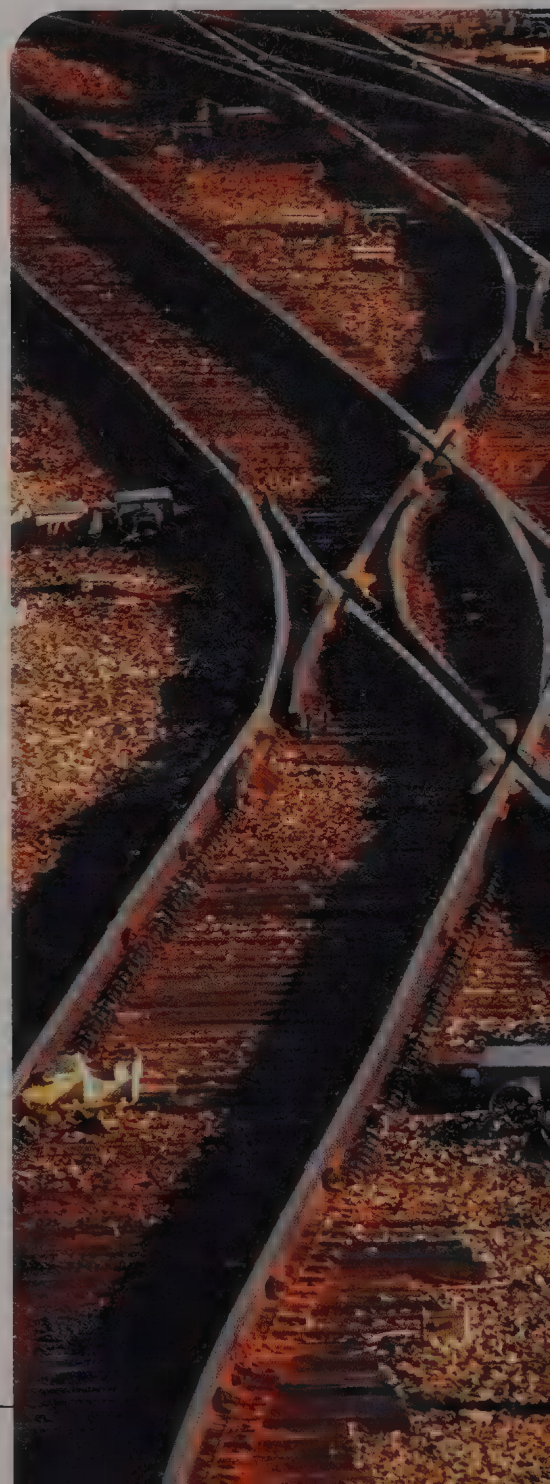
What Have IASB and FASB Convergence Efforts Achieved?

by Paul Pacter, CPA, Ph.D.



For nearly 40 years, the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC), have been working to develop a set of high-quality, understandable, and enforceable International Financial Reporting Standards (IFRS) to serve equity investors, lenders, creditors, and others in globalized capital markets. When the IASB took over from the IASC in 2001, few countries had adopted International Accounting Standards (as IFRS were then called) even for cross-border public sales of securities, let alone for domestic public companies.

That all changed—and quite dramatically—with two events. First, in 2000, the International Organization of Securities Commissions (IOSCO) endorsed IFRS for cross-border securities offerings in the world's capital markets. Then, in 2002, the European Union made the bold decision to require IFRS for all companies listed on a regulated European stock exchange starting in 2005. Those events started a snowball rolling, to the point where today roughly 100 countries require IFRS or a national word-for-word equivalent for all or most listed companies.

Editor's note: Paul Pacter served as a member of the International Accounting Standards Board (IASB) from July 2010 to December 2012. This analysis and table represent Pacter's opinions and do not necessarily reflect the views of other current or former IASB members, or official positions of the IASB or the IFRS Foundation.

Almost from the outset, a key goal of the IASB and the IFRS Foundation, under which the IASB operates, has been to bring the United States on board. In a plenary address at the World Congress of Accountants in 2002, Paul Volcker, the first chairman of the Foundation's trustees, said: "I do not think it reasonable today, if it ever was, to take the position that U.S. GAAP should, de facto, be the standards for the entire world. Rather, the International Accounting Standards Board, whose oversight trustees I chair, is now working closely with national standard setters throughout the world to develop common solutions to the accounting challenges of the day. The aim is to find a consensus on clearly defined principles, and I am delighted that the American authorities appear sympathetic to that objective."

PHOTO BY JUPITERIMAGES/THINKSTOCK

In October 2002, the IASB and FASB signed a memorandum of understanding that has come to be known as the "Norwalk Agreement." The two boards pledged to use their best efforts to (a) make their existing financial reporting standards "fully compatible as soon as is practicable" and (b) "to coordinate their future work programs to ensure that once achieved, compatibility is maintained." "Fully compatible" was generally understood to mean that compliance with U.S. GAAP would also result in compliance with IFRS. That is, the standards would be aligned though not identical.

With the Norwalk Agreement, the boards launched a series of both short-term and longer-term convergence projects aimed at eliminating differences in the two sets of standards. The two boards agreed that where either IFRS or U.S. GAAP had the clearly preferable standard, the other board would adopt that standard. And where both boards' standards needed improvement, the boards would work jointly on an improved standard.

The Norwalk Agreement has been updated several times since 2002, but always with the objective of two sets of standards that were converged in principle if not in words. The IFRS-U.S. GAAP convergence approach has been repeatedly endorsed by global financial leaders such as the G-20 as an important step on the path toward a single set of global accounting standards.

In November 2007 an important milestone was achieved toward use of IFRS in the United States when the SEC eliminated the requirement that a foreign issuer using IFRS must present a reconciliation of IFRS measures of profit or loss and owner's equity to amounts that would have been reported under U.S. GAAP. In their comment letter on the SEC proposal that led to removal of the reconciliation, FASB and the Financial Accounting Foundation wrote:

> Investors would be better served if all U.S. public companies used accounting

standards promulgated by a single global standard setter as the basis for preparing their financial reports. This would be best accomplished by moving U.S. public companies to an improved version of International Financial Reporting Standards (IFRS).

So, where are we today after 10 years of convergence work? Some convergence projects have been completed successfully as envisioned—aligned principles even if the words differed. Others have been completed with partial success—some progress toward converged standards, but some differences remain. And some convergence projects either were discontinued or resulted in different IASB and FASB standards because, in the end, the two boards just could not agree. Some convergence projects continue to this day, including such major projects as revenue recognition, leases, and financial instruments.

At this point, it is reasonable to sit back and ask two fundamental questions about each of those convergence projects:

1. Have IFRS and U.S. GAAP been converged?
2. Even if convergence was not successfully achieved, has IFRS been improved?

The accompanying table, "Results of Convergence," sets out my admittedly subjective views about the success of convergence and the resulting improvements to IFRS for each of the projects listed in the various agreements between the IASB and FASB. As a final thought, I would add that convergence may have been the most realistic way to initiate the use of IFRS in the United States, but such an arrangement is not sustainable in the long term. Rather, the best approach for any jurisdiction is outright adoption of IFRS. As the trustees of the IFRS Foundation said recently in the report of their 2011 Strategy Review:

> As the body tasked with achieving a single set of improved and globally accepted high quality accounting standards, the IFRS Foundation must remain committed to the long-term goal of the global adoption of IFRSs as developed by the IASB, in their entirety and without modification. Convergence may be an appropriate short-term strategy for a particular jurisdiction and may facilitate adoption over a transitional period. Convergence, however, is not a substitute for adoption. Adoption mechanisms may differ among countries and may require an appropriate period of time to implement but, whatever the mechanism, it should enable and require relevant entities to state that their financial statements are in full compliance with IFRSs as issued by the IASB.

Adoption is the only way to achieve a single set of global financial reporting standards—an objective that both the IASB and FASB have publicly endorsed on many occasions.

AICPA RESOURCES

JofA articles

- "Still in Flux: Future of IFRS in U.S. Remains Unclear After SEC Report," Sept. 2012, page 28
- "A New System for Recognizing Revenue," Jan. 2012, page 30
- "New IASB Leader Embraces Challenges," Sept. 2011, page 30
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Websites

- AICPA advocacy, tinyurl.com/d9ldxqf
- IFRS Resources, ifrs.com

EXECUTIVE SUMMARY

- **In this opinion piece, former International Accounting Standards Board (IASB) member Paul Pacter describes the accomplishments of the convergence project** undertaken in 2002 by the IASB and FASB. He says many standards have converged, and IFRS have been improved as a result of the process.
- **On a standard-by-standard basis, results of convergence have been mixed, Pacter says.** Some standards have been improved. Some have not changed because the boards couldn't agree on a converged solution. And a few–revenue recognition, leases, and financial instruments–remain under development.
- **According to Pacter, although progress has been made through convergence, adoption of IFRS for U.S. financial reporting is the ultimate goal.** He says adoption is the best approach for any jurisdiction.

Paul Pacter (ppacter@ifrs.org) is a former member of the International Accounting Standards Board.

To comment on this article or to suggest an idea for another article, contact Ken Tysiac, senior editor, at ktysiac@aicpa.org or 919-402-2112.

RESULTS OF CONVERGENCE

A Look at the Outcome of Key Joint IASB/FASB Projects

Topic	IASB/FASB Action	Convergence Outcome	Was IFRS Improved?
Borrowing Cost	In January 2009 the IASB amended IAS 23 to require capitalization (the U.S. principle).	Converged on the broad principle of capitalization of borrowing costs. Differences in how borrowing costs eligible for capitalization are defined and calculated and on which assets are eligible.	IFRS were improved because a free-choice option was removed. Whether capitalization or expensing is the better principle is debatable.
Business Combinations	New standards issued by both boards.	Partial convergence. Differences remain, including: ▪ Measurement of goodwill (the IASB allows either 100% of goodwill or only the parent's share. FASB is 100% only). ▪ The level at which the goodwill impairment test is imposed.	Yes, particularly in eliminating pooling-of-interests accounting. Some argue that IFRS 3 would have been further improved if the result had been a single measure for goodwill, rather than two. However, there was only limited support among IFRS preparers and users for the 100% goodwill approach.
Combinations of Entities Under Common Control	No action by the IASB. U.S. GAAP already requires "pooling of interests."	Not converged.	There was no standard, hence no improvement.
Conceptual Framework	In September 2010, the IASB and FASB published virtually identical chapters on "Objectives and Qualitative Characteristics" of the new *Conceptual Framework*. No other sections finished.	Converged on objective and qualitative characteristics. Other parts of the *Framework* were already broadly converged.	Readability was improved, but many question replacement of prudence with neutrality.
Consolidation (including special-purpose entities)	The IASB completed IFRS 10 in May 2011. FASB did not agree with effective control as the basic principle and did not join the IASB in the project.	Convergence broadly achieved for off-balance-sheet activities and disclosures about unconsolidated structured entities. Not converged with respect to control and de facto control as the basis for consolidation.	There is a more clearly articulated effective control principle, clearer guidance for consolidating special-purpose vehicles, and much-improved disclosures.
Corrections of Errors	The IASB amended IAS 8 to require restatement, but the IASB added an impracticability exception that does not exist in U.S. GAAP.	Broadly converged.	Yes, though some question the need for an impracticability exception.
Derecognition of Financial Assets and Liabilities	Despite a joint exposure draft, in the end, the boards could not agree on derecognition principles for removing financial assets from the balance sheet. The boards agreed on broadly aligned disclosures in October 2010.	No success in convergence of derecognition principles. Substantial success on converged disclosures.	Improved disclosures, but no improvement to the principles for derecognition.
Discontinued Operations	The IASB adopted IFRS 5. FASB adopted Statement No. 144. Converged on timing for classifying an operation as discontinued. Not converged on definition of discontinued operation or on whether to present discontinued operations on the face of the income statement.	Substantial success.	Yes, IFRS were improved. (And many prefer the IASB's answer to FASB's).
Earnings per Share	In August 2008 the IASB issued an ED proposing amendments to IAS 33. This was never finalized. Nor did FASB propose similar amendments to U.S. GAAP.	IAS 33 and U.S. GAAP were broadly converged in the project. Nothing has changed.	Because no action was taken, there was no improvement.

Topic	IASB/FASB Action	Convergence Outcome	Was IFRS Improved?
Emissions Trading	In November 2010 the IASB and FASB decided to defer work on this project.	Not converged. Neither the IASB nor FASB has standards directly on point.	There was no standard, hence no improvement.
Extractive Industries	In April 2010 the IASB published a Discussion Paper. No action since. FASB already has an oil and gas standard.	Not converged.	There was no standard, hence no improvement.
Fair Value Measurement	IASB issued IFRS 13 as a virtually word-for-word equivalent to FASB Statement No. 157.	Substantial success.	Yes, the guidance on fair value in IFRS is much improved and made consistent across standards, plus disclosures were enhanced significantly.
Fair Value Option for Financial Assets	FASB has added a fair value option to its financial instruments standards similar to what the IASB had.	Converged regarding fair value option. But the issue is under reconsideration in the broader joint project on classification and measurement of financial instruments.	There was no change to IFRS, which already had a fair value option.
Financial Instruments—Hedge Accounting	Currently, IAS 39 and U.S. GAAP are substantially converged on hedge accounting (other than macro hedging). The IASB will soon issue a new general hedge accounting standard that will result in significant divergence from U.S. GAAP.	Not converged.	Despite lack of convergence, the IASB's new general hedge accounting standard is a significant improvement to IFRS.
Financial Instruments—Impairment of Assets Carried at Amortized Cost	Still in process.	Both boards have agreed to adopt an expected loss approach rather than today's incurred loss approach. However, the two boards are currently heading toward different ways of implementing that approach.	Moving to an expected loss approach is an improvement in principle. The specifics have not yet been decided.
Financial Instruments—Classification and Measurement	The two boards went different ways: The IASB issued IFRS 9 in November 2009 (for assets) and October 2010 (for liabilities). Some financial assets amortized cost and some fair value through profit or loss (FVTPL), (and some equity instruments at fair value through other comprehensive income, or FVOCI). Most liabilities at amortized cost, but with fair value option (FVO) and other comprehensive income (OCI) option for own credit. FASB proposed a full fair value model, but is now moving to a mixed measurement model different from the IASB's.	Limited success in convergence.	Many thought IFRS 9 was an improvement over IAS 39. But those improvements are being eroded in the interest of convergence because of additional categories of financial assets, greater use of OCI, recycling, and inconsistent treatment of "available for sale" debt and equity instruments.
Government Grants	No action.	Not converged.	There was no change in IFRS.
Impairment of Nonfinancial Assets	In 2008 the boards decided to defer pending completion of "other work."	Not converged.	There was no change in IFRS.
Income Tax	In March 2009 the IASB issued an ED (not with FASB) proposing amendments to IAS 12 basically to eliminate exemptions from recognizing deferred taxes. Responses were generally not supportive. The IASB did not finalize the ED. Small amendments to IAS 12 were made later.	Even before convergence work began, IFRS and U.S. GAAP were converged on the principle of the temporary difference method, although not converged on how that method is implemented. There has been no success in eliminating the differences.	Even though there was no convergence, the process did result in a few amendments to IFRS 12 that are considered improvements.

Topic	IASB/FASB Action	Convergence Outcome	Was IFRS Improved?
Insurance	Still in process.	Joint project offers a prospect for partial success in convergence.	This will be a significant improvement to IFRS when the project is finished (even if not converged with U.S. GAAP) because currently there is no IFRS and a wide range of practices are acceptable.
Investment Entities	In this joint project, the IASB has adopted a new definition of investment entity and requires such entities to account for subsidiaries at FVTPL. FASB has not finished its revised definition but already requires FVTPL.	Prospect for partial success.	Most people would regard replacing consolidation with FVTPL for an investment entity as an improvement.
Investment Property	The IASB has a standard, IAS 40. FASB has been working on one, but work is deferred.	Not converged, and prospects are not good in the near term.	This project would have involved FASB adopting IAS 40 in some way rather than the IASB changing IAS 40. No improvement to IFRS.
Joint Ventures	The IASB completed IFRS 11 in May 2011. Proportionate consolidation is used in the United States in the real estate and extractive industries. U.S. GAAP on joint ventures differs from IFRS 11.	Not converged.	Yes, distinguishing between different types of joint ventures was an improvement. However, many analysts will miss the information provided by proportionate consolidation, which remains available in the United States for real estate and extractive industries.
Leasing	Still in process.	Both boards expect to ballot a revised ED in the first half of 2013. Whether their final standards will be converged is hard to predict at this point. Note that IAS 17 and FASB Statement No. 13 were broadly converged before the joint project started.	This project is not yet complete. Putting right-of-use assets and lease obligations on the balance sheet would be an improvement of IFRS. However, the goal of a single accounting model for all leases does not seem to be achievable.
Liabilities and Equity (distinction between) Also called Financial Instruments With Characteristics of Equity (FICE)	In November 2010 the IASB and FASB decided to defer work on this project.	Not converged. The United States has not adopted the IAS 32 principle that an instrument is a liability if the issuer does not have the unilateral right to avoid paying cash. Also the United States has not adopted the "split accounting" for the equity component of convertible debt issued. The United States did not finalize its narrow view of equity proposed in November 2007.	There were no changes to IFRS, hence no improvement.
Liabilities—Measurement of	In November 2010 the IASB and FASB decided to defer work on this project.	Not converged.	The IASB's proposed measurement of all liabilities on an expected value basis would have been an improvement.
Nonmandated Change in Accounting Policy	In its 2003 improvements project that was not part of convergence, the IASB amended IAS 8 to require restatement. Subsequently, as part of convergence, FASB amended U.S. GAAP to require restatement.	Converged.	Yes, this was a significant improvement.

Topic	IASB/FASB Action	Convergence Outcome	Was IFRS Improved?
Offsetting of Financial Assets and Financial Liabilities	The two boards issued a joint ED along the lines of the gross presentation in IAS 32. But after reviewing comments, FASB decided not to pursue requiring a gross presentation. Joint disclosure standards were issued, though FASB now plans to defer part of it.	Not converged on offsetting, but converged on disclosure.	Significant improvement in disclosure. Some improvements. Also the IASB improved the gross presentation approach in IAS 32.
Post-Retirement Benefits	Both boards made some changes, but not a converged standard: 1. Past service cost treatment unchanged by either board. 2. FASB has eliminated the corridor for balance sheet purposes, but has retained it for income statement purposes. The IASB has eliminated the corridor for both income statement and balance sheet purposes. However, when eliminating the corridor, the IASB changed the rate that is used to calculate the return on plan assets whereas FASB continues to use an expected return (previously converged). 3. Termination benefits are broadly converged. 4. Neither board has fixed cash balance plans.	Not converged. The resulting differences in the rates used to calculate return on plan assets are significant.	Yes, there were significant improvements to IFRS.
Reclassification of Financial Assets	The IASB amended IAS 39 to permit reclassification, which U.S. GAAP had allowed.	Substantially converged.	Most would say this was not an improvement to IFRS, but they acknowledge that this was a necessary move during the financial crisis.
Reporting Financial Performance (morphed into Financial Statement Presentation)	In November 2010 the IASB and FASB decided to defer work on this project.	Not converged.	There were no changes to IFRS, hence no improvement.
Research and Development	The IASB added intangible assets to its research agenda, but it has not become an active project.	Not converged. All R&D expensed under U.S. GAAP. Some development costs capitalized under IAS 38.	There was no change to IFRS, hence no improvement.
Revenue Recognition	Joint ED June 2010 proposing joint standard including nearly identical wording. Revised joint ED November 2011 with some wording differences, but substantively same accounting.	Both boards expect to ballot converged standards in the first half of 2013.	Yes, this project will lead to a significant improvement in revenue recognition and measurement when completed.
Segment Reporting	The IASB adopted FASB Statement No. 131 as IFRS 8 with some minor changes.	Converged.	Some would say yes, but others (including many research analysts) would say no. A post-implementation review is under way.
Share-Based Payment (SBP)	Both the IASB and FASB issued standards requiring accrual of SBP expense. Similar but not identical measurement.	Converged.	Yes, IFRS 2 was a major improvement to IFRS.

Topic	IASB/FASB Action	[illegible]	Was IFRS Improved?
Single Performance Statement	In May 2010 the two boards jointly proposed to require a single performance statement (a single statement of comprehensive income (SOCI)). Both boards received mixed views but more negative in the United States. The IASB was willing to finalize the ED, but FASB was not. In June 2011 FASB amended its standards to require a SOCI and to allow an option of a single performance statement or two (income statement and SOCI). These were already IFRS requirements. The IASB made some changes to converge its SOCI format with FASB's.	Converged, but the outcome was different from the joint EDs.	From an IFRS perspective, the only change was to require segregation and disclosures relating to recyclable items. This was a modest improvement. The proposed significant improvement of a single performance statement was not achieved.
Subsequent Events **Also called Events After Balance Sheet Date**	FASB adopted U.S. guidance on subsequent events that had been in the U.S. auditing standards. Some of that guidance was consistent with IFRS. But FASB did not amend the U.S. guidance to conform to IFRS on (a) classification of liabilities refinanced after balance sheet date or (b) date through which subsequent events must be evaluated.	Not converged, but closer.	No change to IFRS, which most believe has the better answer.

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Source: Former IASB member Paul Pacter.

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Stopping Tax Identity Theft:

Practical Advice for CPAs and Clients

Learn preventive actions and ways to correct problems after a thief has struck.

by Valrie Chambers, CPA, Ph.D., and Rabih Zeidan, CPA, Ph.D.

Tax return and other tax-related identity theft is a growing problem that CPAs can help their clients with—both in taking preventive actions and in correcting problems after an identity thief has struck. Tax return identity theft occurs when someone uses a taxpayer's personal information, such as name and Social Security number (SSN), without permission to commit fraud on tax returns to claim refunds or other credits to which a taxpayer is not entitled, or for other crimes.

Thieves normally file early in the tax-filing season, often before the IRS has received Forms W-2 or 1099, to thwart information matching and avoid receiving duplicate return notices from the IRS. Taxpayers sometimes discover they are victims of identity theft when they receive a notice from the IRS stating that "more than one tax return was filed with their information or that IRS records show wages from an employer the taxpayer has not worked for in the past" (FS-2012-7 (January 2012)).

In 2011, the IRS processed about 145 million returns. About 109 million were claims for refunds, with an average refund amount of almost $3,000. As of May 16, 2012, the IRS had pulled 2.6 million returns for possible identity theft, and that trend is on the increase. The IRS recently reported an inventory of more than 450,000 identity theft cases. For the 2011 filing season, the Treasury Inspector General for Tax Administration (TIGTA) estimated that identity-theft-related fraud accounted for approximately 1.5 million tax returns in excess of $5.2 billion.

Consequences of Identity Theft

Tax return identity theft delays legitimate taxpayer refunds because the return appears to be a duplicate return and may be a sign of other fraud or identity theft problems. IRS support to solve traditional and nonfraud problems may be delayed as well when IRS resources are diverted to combat identity theft. Other tax-related identity theft can cause problems for the taxpayer as well. If an individual fraudulently used a taxpayer's SSN to get a job, the taxpayer may have extra W-2 wages erroneously reported (and perhaps also extra taxes withheld), leading to a correspondence matching audit. The National Taxpayer Advocate notes that time and money are spent to clear the individuals' names, during which "victims may lose job opportunities, may be refused loans, education, housing or cars, or even get arrested for crimes they didn't commit" (IRS Publication 4535, *Identity Theft Prevention and Victim Assistance*).

Further, until recently, the IRS would hold suspicious refunds while verifying the underlying W-2 information, for up to 11 weeks. With the increase in the number of cases and budget limitations, refunds may take longer. So, the IRS says, "[I]dentity theft can impose a significant burden on its victims, whose legitimate refund claims are blocked and who often must spend months or longer trying to convince the IRS that they are, in fact, victims and then working with the IRS to untangle their account problems" (IR-2012-66).

A typical identity theft starts when thieves have (illegally) bought or stolen information from individuals, employers, hospitals, or nursing homes or have used the public list of deaths with SSNs issued by the Social Security Administration. With a number or list of numbers, they file false tax returns for refunds. For example, investigators found a single address that was used to file 2,137 tax returns for $3.3 million in refunds (see TIGTA Rep't No. 2012-42-80). Most thieves prefer to receive the refund using direct deposit or prepaid debit cards. In another example, 590 tax refunds totaling more than $900,000 were deposited into a single bank account. Although banks have strict rules to verify the identity of account holders, they don't have the ability to monitor whether the direct deposit is for a legitimate refund.

Although the IRS planned to spend about $330 million in 2012 to combat identity theft, the IRS has limited resources and needs additional funding to combat this problem. Identity theft also happens to tax systems in other countries, but the extent of the problem is lessened in countries where the government can immediately (or in "real-time") match income and withholding with the tax return. IRS Commissioner Douglas Shulman called for real-time matching in his prepared remarks at the AICPA Fall 2011 National Tax Conference for the purpose of reducing the number of taxpayer audits, but such a system should help reduce identity theft fraudulent tax returns as well (IR-2011-108).

Identity Theft in the Making: How ID Is Stolen

Common ways to obtain personal information include email or telephone phishing and Dumpster diving. Thieves are looking for "discarded tax returns, bank records, credit card receipts or other records containing personal and financial information" (FS-2008-9 (January 2008)). For example, some taxpayers receive email messages allegedly from the IRS advising them that they

Exhibit 1 Sample of Phishing Email

Title/Subject of email: Your Tax Refund Payment Update
[attachment to email is "Refund Form.html"= link to webform]
From: taxupdates@irs.org

After the last annual calculations of your fiscal activity we have determined that you are eligible to receive a tax refund of $ 826.28

Submit the tax refund request and allow us 3–5 business days in order to process it.

A refund can be delayed for a number of reasons. For example submitting invalid details which we don't have on record or applying after the deadline.

Download, fill and submit your Tax Refund Form in order to complete the process.

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are under investigation or have a refund pending. To get the victim to respond, the email may threaten a dire consequence (see Exhibit 1 for a typical phishing message). Often, the recipient is asked to click on a link to access what appears to be—but is not—the legitimate IRS website.

The IRS does not send unsolicited, tax-account related emails to taxpayers and never asks for personal and financial information, including PINs and passwords, via email. The IRS advises that "[s]ince the IRS rarely contacts taxpayers via e-mail, and never about their tax accounts, taxpayers should be cautious about any e-mails that claim to come from the IRS" (FS-2008-9). (People receiving a suspicious email from the IRS are encouraged to report the email by calling the IRS at 800-829-1040 or forwarding the email to phishing@irs.gov; note in Exhibit 1 how the email uses "irs.org" not "irs.gov.")

Identity Theft Detection: How Identity Theft Is Caught

The IRS has several filters that address different issues. These filters are designed to distinguish legitimate returns from fraudulent ones and to prevent the recurrence of identity theft. If a tax return is caught by a filter, it is manually reviewed to validate the taxpayer's identity. If the IRS identifies a suspicious return, it corresponds with the taxpayer to verify the correct information. Alternatively, if a second, unauthorized person is using the taxpayer's SSN, the taxpayer may receive a correspondence audit notice informing the taxpayer that he or she failed to report income from another (erroneous) employer.

When a taxpayer's identity has been stolen, the legitimate taxpayer may be issued a confidential identity protection PIN (IP PIN) that identifies the taxpayer as the legitimate party using the SSN and other identifying information. The IRS issues these numbers to taxpayers who have reported that their identities have been stolen, verified their identities, and had an identity theft indicator applied to their accounts. Not all victims of identity theft will receive an IP PIN—the IRS says that taxpayers who submitted Form 14039, *Identity Theft Affidavit*, and proper documentation or taxpayers whom the IRS has itself identified as victims will receive them. During the 2012 filing season, the IRS issued 250,000 IP PINs, up from about 54,000 the year before. Once the IP PIN has been issued, it must be present and correct on the specific tax return for which it was issued. For the 2012 tax year, the six-digit IP PIN is inserted at the bottom of page 2 of Form 1040, to the right of the taxpayers' signatures.

If two taxpayers are married filing jointly and each taxpayer receives an IP PIN, the couple should use the IP PIN of the SSN that appears first on the tax return. Tax preparation software is generally equipped to ask taxpayers if they received an IP PIN. If a taxpayer is filing a printed copy of the return, however, this number will not print, and should be handwritten in the space provided. A request for an extension or installment agreement using an IP PIN must be made on paper, but the tax return may still be filed electronically.

A new IP PIN is issued every subsequent year as long as the theft indicator remains on the legitimate taxpayer's account. Returns with an IP PIN are processed more efficiently, in that they bypass the regular filtering system, and the IP PIN prevents fraudulent returns from being processed. The IRS began a pilot program in 2010 to mark the accounts of deceased taxpayers to prevent misuse by identity thieves.

Identity Theft Corrective Actions: What to Do If an Identity Is Stolen

As trusted financial advisers, CPAs may be asked what to do if a client's identity is stolen. The CPA should consider advising or helping the client with several steps:

1. For tax and nontax identity theft, report the theft to the Federal Trade Commission at 877-438-4338, ftc.gov/complaint, or TTY 866-653-4261.
2. File a report with the local police.
3. Close any affected bank and credit card accounts.
4. Inform the credit bureaus and consider putting a credit freeze on the accounts (see tinyurl.com/ygwoo2j). A credit freeze restricts access to credit reports, making it unlikely that thieves can open new accounts in the client's name. Credit freeze laws vary from state to state.
5. If personal information is lost or stolen

EXECUTIVE SUMMARY

- **Tax-related identity theft is a growing problem** that requires CPAs to learn how to help clients who are victims and how to help clients avoid becoming victims.
- **Identity thieves use taxpayer information obtained illegally,** sometimes by email or telephone phishing, or by Dumpster diving.
- **Identity thieves often file returns early before a legitimate taxpayer has had a chance to file** and before the IRS has received Forms W-2 and 1099 to match with returns.
- **Once an identity is stolen,** a number of steps can be taken to protect taxpayers.
- **The IRS issues special taxpayer identification numbers** to victims to allow them to have their future returns processed without undue delay.
- **There are a number of preventive steps CPAs can advise their clients to take** to avoid becoming victims of identity theft.

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To comment on this article or to suggest an idea for another article, contact Sally P. Schreiber, senior editor, at sschreiber@aicpa.org or 919-402-4828.

during the year, contact the IRS Identity Protection Specialized Unit at 800-908-4490, and complete Form 14039, if necessary. Expect to be patient, though. The National Taxpayer Advocate noted in her semiannual report that "this unit has been unable to answer about two out of every three calls it has received from taxpayers so far this year. At times during the filing season, it was answering only about one out of every nine calls it received—and those who managed to get through waited an average of over an hour to speak with an employee."

6. Respond to all IRS notices immediately, using the name and number printed on the notice.
7. Tax preparers should ask their clients if they received an IP PIN.

Identity Theft Prevention Techniques

Since identity theft is so prevalent and growing, a CPA may consider providing general preventive advice through newsletters, websites, and other communications. This advice may include:

1. Have clients arrange for masked SSNs where possible, e.g., on insurance cards, so that client SSNs are closely protected and circulated as little as possible.
2. Watch credit reports from the three major credit bureaus; consider offering this as an off-season service or adding a timely reminder with contact information to the firm newsletter. (Contact details for the fraud departments of the three major credit bureaus are: Equifax—equifax.com, 800-525-6285; Experian—experian.com, 888-397-3742; and TransUnion—transunion.com, 800-680-7289.)
3. Advise clients to forward all information appearing to be from the IRS promptly and to *not* click on links or open attachments from emails claiming to be from the IRS.
4. Advise clients to safeguard their Social Security cards, store them in a safe and secure location, and not discard any documents with an SSN on them.
5. Advise clients to resist giving businesses an SSN or other personal information just because they ask for it; often it is not required, and dissemination of SSN information is risky.
6. Advise clients to protect financial information by investing in and using a shredder before discarding documents.
7. A taxpayer should secure personal information in one's own home. For example, copies of tax returns can be kept in a locked file cabinet or safe.
8. Taxpayers should protect personal computers by using firewalls and anti-spam or anti-virus software, updating security patches, and regularly changing passwords for internet accounts with sensitive information, such as online banking sites.

CPAs may be able to take additional preventive steps for tax returns, where the client is cooperative:

1. File clients' returns early if possible.
2. E-file returns to be notified of duplicate return notices more quickly.
3. Consider truncating or masking SSNs on Forms 1098, 1099, and 5498 consistent with Notice 2011-38.
4. Communicate with the client to change client expectations: Refunds might take longer in future years as additional system security steps are taken.
5. Finally, CPAs with new online clients should be very careful to confirm the identity of those new clients, so that an identity thief cannot trade on an unwitting CPA's credibility in filing false returns.

CPAs can find additional information at:

- IRS website (tinyurl.com/9y79lhl), and
- IRS resources including the Taxpayer Guide to Identity Theft page, available at tinyurl.com/9gvyxtv, or the Identity Protection page, available at tinyurl.com/9y2qrrp. ❖

Authors' note: *The authors thank the AICPA IRS Practice and Procedures Committee for help with this article.*

AICPA RESOURCES

***JofA* article**

- "Preventing Identity Theft Throughout the Data Life Cycle," Jan. 2009, page 58

Use journalofaccountancy.com to find past articles. In the search box, click "Open Advanced Search" and then search by title.

Insider articles

- "Identity Theft and Fraudulent Tax Returns," *CPA Insider*, June 11, 2012, tinyurl.com/cul9ead
- "Identity Theft: What Is It and What Is the IRS Doing About It?" *Tax Insider*, Dec. 8, 2011, tinyurl.com/7xubnvc

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CPE Credits: 12.5

This intensive interactive program is designed to provide auditors with the basic fundamentals required to audit employee benefit plans in accordance with AICPA standards and EBSA requirements. Through case studies and hands-on work sessions, you'll cover all aspects of the audit procedures for defined benefit and 401(k) plans.

Fair Value Measurements Workshop

March 25-26, 2013 | AICPA Boardroom, New York, NY

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Mark Zyla, renowned fair value measurement expert, will lead this workshop. Through case studies, examples and discussion, the workshop will show members in business and industry as well as their outside auditing firms the information necessary to confront the challenges in making and attesting to fair value.

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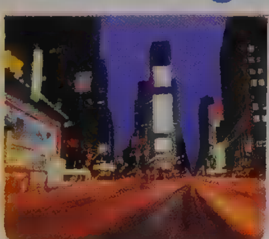

May 2-3, 2013 | AICPA Boardroom, New York, NY

CPE Credits: 12.5

As part of the Executive Boardroom Series and co-sponsored by the AICPA and the ERM Institute at NC State University's Poole College of Management, the highly interactive workshop offers a hands-on approach with the tools, resources and networks to help position your organization's sustainability focus in the context of long-term strategies.

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As the scope of specialized services that CPAs can offer continues to expand, savvy practitioners will stake out practice areas where they can take the lead as valued and trusted advisors.

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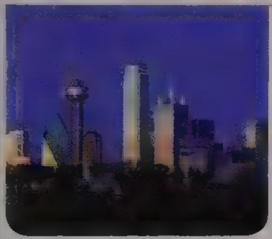
AICPA Conference on Employee Benefit Plans



May 14-16, 2013 | Gaylord Texan, (Grapevine) Dallas, TX

CPE Credits: 22 (main) up to 8 (optional)

The AICPA Conference on Employee Benefit Plans provides you with key updates on recent and proposed legislative changes and regulatory issues. Presented by some of the industry's leading experts, including Department of Labor and IRS representatives, this three-day event will offer the information you need to perform high-quality employee benefit plan audits and provide up-to-date tax guidance.

AICPA CFO Conference

May 15-17, 2013 | Marina del Rey, CA

CPE Credits: 19

The AICPA National CFO Conference is an intensive event that covers the key issues of the day and provides the information and tools you need to engage and prosper in the global economy. Industry experts will guide you through the profound changes shaping our world and help you improve risk management capabilities, leadership skills, and ability to make the best decisions for your organization's future. Plan to build your own personal network with peers, speakers and committee members during interactive sessions, open forum discussions, two networking receptions, and daily networking luncheons.

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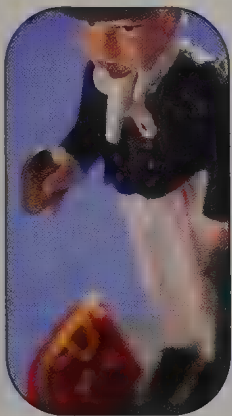

TAX PRACTICE CORNER

Don't Neglect to Elect, Part 4

As a fourth installment in an occasional series, here are additional tax elections for estates, partnerships, and individuals.

Estates

Election to treat a revocable trust as part of an estate. Sec. 645 allows for an election to treat a qualified revocable trust (QRT) as part of a decedent's estate for federal income tax purposes. A QRT is a grantor trust under Sec. 676 (with revocation power retained by the grantor) as of the decedent's date of death. Accordingly, a testamentary trust cannot be a QRT.

The advantages of making the election include: the estate and electing trust file a single Form 1041, *U.S. Income Tax Return for Estates and Trusts*; the electing trust can adopt a fiscal year; the electing trust is not subject to the active-participation requirement under the passive loss rules for two years; the electing trust can hold S corporation stock without terminating the corporation's S election; and the electing trust will be allowed a charitable deduction under Sec. 642(c) for amounts permanently set aside for charitable purposes. The election is made by the trustee and executor on Form 8855, *Election to Treat a Qualified Revocable Trust as Part of an Estate*, by the due date, including extensions, of the estate's (or in a case where there is no executor of the estate, the filing trust's) initial income tax return. If there is more than one executor of the estate or more than one trustee for an electing QRT, only one executor or trustee must sign Form 8855, unless otherwise required by applicable local law or the governing document. As it is possible to have more than one QRT, the trustee, or, where required, trustees, of each QRT joining in the election must sign Form 8855. The election is irrevocable.

Partnerships

Election out of partnership treatment by a spousal joint venture. If spouses co-own a business and the business is not incorporated, a partnership may exist, and a partnership return may need to be filed. However, if the business qualifies, the spouses can make a qualified joint venture (QJV) election under Sec. 761(f) as an alternative to being taxed as a partnership. A QJV is a trade or business in which only the husband and wife are partners, each spouse materially participates *individually* under the passive loss rules, and both spouses elect QJV status. This election avoids partnership taxation with its complexities and enhanced failure-to-file penalties. Tax return preparation may be simpler, and both spouses can earn Social Security and Medicare credits.

Using QJV status, all items of income, gain, loss, deduction, and credit are divided between the spouses based on their respective interests in the venture, and each spouse takes his or her share of these items into account as if they were attributable to a trade or business conducted by the spouse as a sole proprietor. Therefore, each spouse generally reports his or her share of the items on a separate Schedule C, *Profit or Loss From Business*, or Schedule F, *Profit or Loss From Farming*. Each spouse must also file a separate Schedule SE, *Self-Employment Tax*, if applicable. In the case of a rental real estate business, the spouses file Schedule E, *Supplemental Income and Loss*. They do not file separate Schedules E; instead, each spouse's separate interest is entered as a separate property on a single Schedule E.

For QJVs reported on Schedule C, the QJV election is made by filing a joint return and reporting all items of the business's income, gain, loss, deductions, and credits as described above. For QJVs reported on Schedule E, the election is made by checking the "QJV" box on line 2 of Schedule E for each property that is part of a QJV and reporting the items for that property interest separately on the form. The election cannot be revoked without IRS consent.

Individuals

Election out of alimony treatment. Under Sec. 71(b)(1)(B), alimony does not include payments that would otherwise be treated as alimony (deductible to the payor, includible in income to the payee) if the spouses designate in a divorce or separation instrument that the payments not be treated as alimony. Electing to not treat payments as alimony would be beneficial in instances where the payor spouse's income is primarily from nontaxable sources or where the payor spouse's income is sheltered by other deductions and exemptions.

The election is made by attaching a copy of the instrument containing the designation of payments as nonalimony to the payee spouse's original return for each year the election applies (see Temp. Regs. Sec. 1.71-1T(a), Q&A-8).

Election to maximize the investment interest deduction. The deduction for individuals for investment interest expense

PHOTO BY LIQUIDLIBRARY/JUPITERIMAGES/THINKSTOCK

is limited to net investment income, which is the excess of investment income over investment expenses. In the calculation, net investment income does not include qualified dividends or net capital gains unless the taxpayer elects to have these items included as part of investment income.

Individuals can make an election to include qualified dividends and net capital gains in the calculation of net investment income for purposes of maximizing the investment interest deduction. If the election is made, the taxpayer waives the right to the lower tax rate on long-term capital gains on the amount elected to be included in net investment income, and it is taxed as ordinary income. The election to include net capital gains is limited to the lesser of net capital gains from investment property or net gains from investment property.

Making this election requires some analysis, as the individual may have sufficient net investment income without the qualified dividends and net capital gains. Also, any unused investment interest expense carries over to future years. Therefore, deciding whether to make the election requires a look at future years' marginal tax rates, expected net investment income, and the taxpayer's discount rate or factor for the time value of money. To make the election, enter on line 4g of Form 4952, *Investment Interest Expense Deduction*, the amount of qualified dividends and net capital gain to include in investment income. The election is made on the tax return for the year that the election is effective.

Request extension of time for making an election. A taxpayer who misses a filing deadline for a regulatory election may request a letter ruling from the IRS granting an extension of time to make the election under Regs. Sec. 301.9100-3. The IRS will grant relief only for failure to timely file a regulatory election, not a statutory election, under this provision. Relief will be granted if the taxpayer provides evidence that establishes to the satisfaction of the IRS that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

The request for the letter ruling must: state whether the taxpayer's return(s) for the tax year in which the election should have been made or any tax years that would have been affected by the election is being examined by the IRS or is being considered by an IRS Appeals office or a federal court; state when the election was required to be filed and when it was actually filed; include copies of documents that refer to the election; when requested, include a copy of the tax returns for the years the taxpayer is requesting an extension and any return affected by the election; and, when applicable, include a copy of returns of other taxpayers affected by the election.

In addition, the letter ruling request should contain an affidavit by the taxpayer as to the discovery of the election's not being filed and why it was not filed timely and affidavits from the taxpayer's tax preparer and any accountant or attorney who provided advice regarding the election. The taxpayer must pay the appropriate user fee for the ruling request.

The letter ruling request should be made as soon as taxpayers realize they failed to file the election. It is filed with the appropriate Associate Chief Counsel's Office of the IRS in Washington. ❖

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CAPITALIZATION OF COSTS

EFFECTIVE DATE OF TANGIBLE PROPERTY REGS. DELAYED

The IRS delayed the mandatory effective date of temporary regulations it issued in December 2011 governing whether tangible property expenses can be deducted or have to be capitalized (T.D. 9564). The temporary regulations originally were to apply to tax years beginning on or after Jan. 1, 2012. In response to numerous comments from taxpayers, in December 2012 the IRS amended the temporary regulations to make them apply to tax years beginning on or after Jan. 1, 2014, instead, but will allow taxpayers to apply the temporary regulations for tax years beginning on or after Jan. 1, 2012, and before the applicability date of final regulations. This makes the use of the temporary regulations optional until 2014. The IRS expects to finalize the regulations in 2013. In Notice 2012-73, the IRS said the final regulations also are expected to apply to tax years beginning on or after Jan. 1, 2014, although taxpayers may choose to apply them to tax years beginning on or after Jan. 1, 2012.

The IRS, recognizing that many taxpayers are expending resources to comply with the temporary regulations, also announced in Notice 2012-73 that when the final regulations are published, the following rules will be revised to simplify them:

- The *de minimis* rule in Temp. Regs. Sec. 1.263(a)-2T(g).
- The rules for dispositions in Temp. Regs. Secs. 1.168(i)-1T and 1.168(i)-8T.
- The safe-harbor rule for routine maintenance in Temp. Regs. Sec. 1.263(a)-3T(g).

The IRS did not specify how these rules would be simplified, but it did note that it would take into consideration comments requesting relief for small businesses.

Taxpayers who choose to apply the rules in the temporary regulations for tax years beginning on or after Jan. 1, 2012, can use the procedures in Rev. Procs. 2012-19 and 2012-20 to obtain automatic consent to change their accounting method. For taxpayers who choose to apply the provisions of the final regulations to tax years beginning on or after Jan. 1, 2012, the IRS says it will publish new automatic consent procedures when the final regulations are issued.

PASSIVE ACTIVITIES

TELECOMMUNICATION TOWER LEASES NOT SUBJECT TO SELF-RENTAL PASSIVE INCOME RULE

The Tax Court determined that a taxpayer's rental income from the lease of land and telecommunication towers to his wholly owned S corporation was not subject to the "self-rental rule" of Regs. Sec. 1.469-2(f)(6). Accordingly, the court held, the IRS's recharacterization of the income as nonpassive was inappropriate. The court, however, agreed with the IRS on the character of rental income from land without towers, holding that the 30% test of Temp. Regs. Sec. 1.469-2T(f)(3) required it to be treated as nonpassive-activity income.

In 2004 and 2005, the years at issue, Francis Dirico leased land and telecommunications towers to his wholly owned S corporation. In exchange, he received a percentage of the S corporation's revenues from its leasing of tower access to its customers. While the majority of the leases were of land and towers, three were of land only. Dirico sustained net losses on four of the leases of land and towers. On his tax returns he reported each of the individual leases as separate passive activities. Income from the profitable leases therefore offset losses from the unprofitable leases. He also reported the entire amount of his distributive share of income from the S corporation as ordinary business income, which was its character on the Schedule K-1 issued to him.

Sec. 469 defines a passive activity as either an activity involving the conduct of a trade or business in which the taxpayer does not materially participate or a rental activity. It further limits deductions of losses from passive activities to the extent of passive income. Under the self-rental rule of Regs. Sec. 1.469-2(f)(6), rental income received for the use of property in a trade or business activity in which the taxpayer materially participates is treated as nonpassive-activity income. This rule equalizes the tax treatment of taxpayers who place property used in their business in a separate entity with those who retain the property in the same entity as the business operations. It also prevents them from artificially creating passive income to offset losses from other passive activities. The rule, however, does not cover losses from a self-rental activity; those are still passive losses deductible only to the extent of passive income.

The IRS asserted that the income from the land and tower leases to the S corporation was from property used in a trade or business in which Dirico materially participated. Thus, it applied the self-rental rule to recharacterize the income from the profitable leases as nonpassive-activity income, but not the losses. It then argued that the income from the land-only leases was nonpassive

because that characterization is required under Temp. Regs. Sec. 1.469-2T(f)(3) when less than 30% of the unadjusted basis of leased property is subject to depreciation. The overall effect of the IRS's adjustments was to disallow the losses from the unprofitable leases, while taxing the income from the profitable leases.

The Tax Court determined that the applicability of the self-rental rule depended on whether the S corporation used the leased land and towers in a trade or business activity. According to the court, the leasing of tower access to third-party customers was clearly a rental (not a trade or business) activity, and Dirico's participation in the activity consequently was irrelevant, as the self-rental rule did not apply. The erroneous reporting on Dirico's Schedule K-1 of the entire amount of the S corporation's income as ordinary business income did not alter the underlying facts. However, since the land-only leases were not provided in connection with any of the leased towers, the court found that they needed to be grouped separately from the land and tower leases under Regs. Sec. 1.469-4(d)(2). Application of the 30% test was therefore appropriate, and because less than 30% of the unadjusted basis of the land-only leases was depreciable, the income from those leases was characterized as nonpassive-activity income.

Although not discussed in the case, the question of whether income is properly characterized as passive takes on added importance with the new 3.8% Medicare tax on net investment income scheduled to begin in 2013. Tax advisers should consider the implications of this tax when determining the appropriate grouping of separate activities.

■ *Dirico*, 139 T.C. No. 16 (2012)

By ***Janet A. Meade****, CPA, Ph.D., associate professor, University of Houston.*

GIFTS & ESTATES

ESTATE'S SETTLEMENT PAYMENTS NOT DEDUCTIBLE

The Tax Court recently held that an estate's settlement payment to one of its beneficiaries was not deductible since the payment lacked adequate consideration and was consistent with the decedent's wishes expressed in her will.

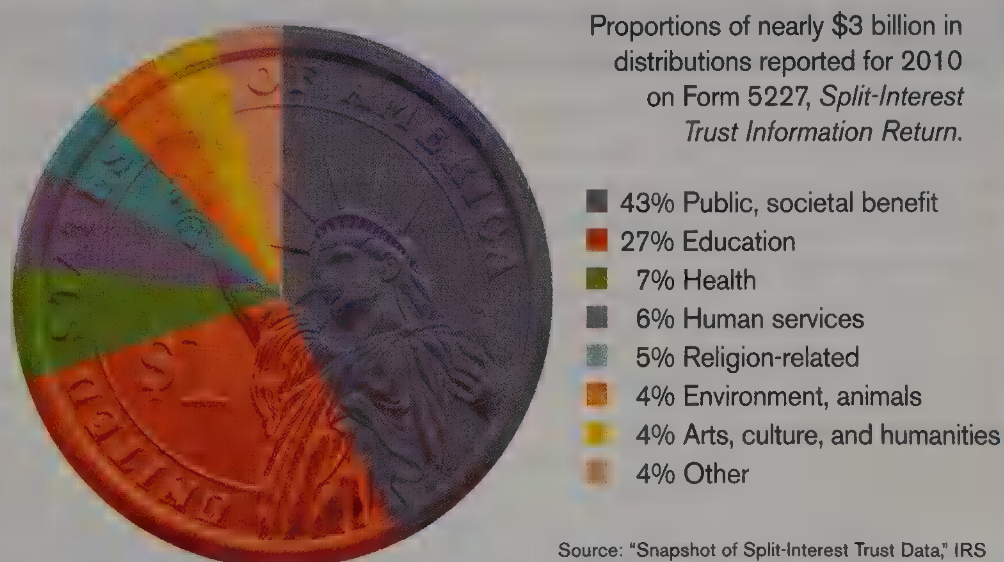
When computing its taxable estate, an estate can deduct a claim against it that represents an enforceable personal obligation of the decedent existing on the date of the decedent's death. In addition, a claim must be founded on a genuine promise or agreement involving full and adequate consideration and cannot be the result of the decedent's testamentary intent.

In 1997 and 1998, Sylvia Bates executed a will and codicil that would, upon her death, create a trust to be funded by the assets that remained in her estate after all expenses were paid. The trust, to be administered by her granddaughter, Sheri Beersman, would distribute the majority of the trust assets equally to Bates's three grandchildren and give $100,000 to Reggie Lopez, an unrelated individual with whom Bates had a close relationship. Beginning in 2004, Bates paid Lopez to help her with various tasks after she was diagnosed with Alzheimer's disease. He was fully paid for his services. In 2005, Bates executed a second will that altered the first will and trust. It named Lopez as executor and trustee and provided that Scott Cable, another of the three grandchildren, would receive all of Bates's personal property, and that Cable and Lopez would each receive half of the trust interest income.

Bates died on Feb. 18, 2005, and Lopez received $23,113 from a life insurance policy owned by Bates. Both wills were submitted for probate, and after nearly a year of legal wrangling, the heirs reached a settlement in which Lopez would receive $575,000 in full satisfaction of all claims related to the estate. In 2006, a court granted Beersman the authority to administer the estate. On the estate tax return, the estate deducted as administrative expenses $498,113, which consisted of the $575,000 settlement payment to Lopez plus the life insurance proceeds of $23,113, minus the $100,000 bequest to him. The IRS disallowed the deduction in its entirety, and in 2010 the estate petitioned the Tax Court for relief.

The IRS argued that the holding in *Estate of Huntington*, 100 T.C. 313 (1993), aff'd, 16 F.3d 462 (1st Cir. 1994), applied.

Charitable Distributions by Split-Interest Trusts, by Charity Type



Source: "Snapshot of Split-Interest Trust Data," IRS Statistics of Income, **tinyurl.com/c643mm8**.

The court in *Estate of Huntington* found settlement payments to beneficiaries were not deductible since they lacked adequate consideration and were consistent with the decedent's testamentary intent. Bates's estate argued that the payments in *Estate of Huntington* were made to family members, and the case at hand was different because Lopez was not a member of the decedent's family. The court disagreed and held the reasoning in *Estate of Huntington* applies equally to cases involving nonfamily members. Even though Lopez was not a family member and other beneficiaries did not want him to receive any assets, he was named as a beneficiary in both trusts and had a legitimate interest in the estate, according to the court. Thus $475,000 of the settlement payment was not deductible.

The estate argued the life insurance proceeds of $23,113 were stolen from the estate since Lopez named himself as the beneficiary, and therefore the amount should be deducted as an administrative expense. The court disagreed, holding that the expenses did not satisfy the requirements of Regs. Sec. 20.2053-3(a), which defines administration expenses as those incurred "in the collection of assets, payment of debts, and distribution of property to persons entitled to it."

■ *Estate of Bates*, T.C. Memo. 2012-314

*By **Charles J. Reichert**, CPA, instructor of accounting, University of Minnesota–Duluth.*

> When computing its taxable estate, an estate can deduct a claim against it that represents an enforceable personal obligation of the decedent existing on the date of the decedent's death.

GIFTS & ESTATES

IRS WON'T FOLLOW *WANDRY*

In Action on Decision 2012-004, the IRS stated it will not acquiesce to the Tax Court's decision in *Wandry*, T.C. Memo. 2012-88, in which the court accepted a taxpayer's use of a defined value formula clause.

In *Wandry*, decided in March 2012, the taxpayers, Joanne and Albert Wandry, executed assignments and memorandums of gifts to their four children and five grandchildren designed to not exceed their annual and remaining lifetime gift exclusion amounts of $1,099,000 for each taxpayer. Each gift document transferred an unstated number of units of the couple's member interests in their family limited liability company (LLC) having a fair market value (FMV) equal to $261,000 to each child and $11,000 to each grandchild. The documents further stated that although the number of units was fixed on the date of the gift in 2004, the number was based on the FMV of the gifts as determined after that date, based on "all relevant information." The donors stated their intent to base the value on an independent third-party appraisal by a qualified appraiser, but that, if the IRS or a court later made a final determination of a different value, the number of gifted units would be adjusted to maintain the dollar values stated in the documents. They obtained an appraisal that determined the value of a 1% member interest in the LLC as of the date of gift.

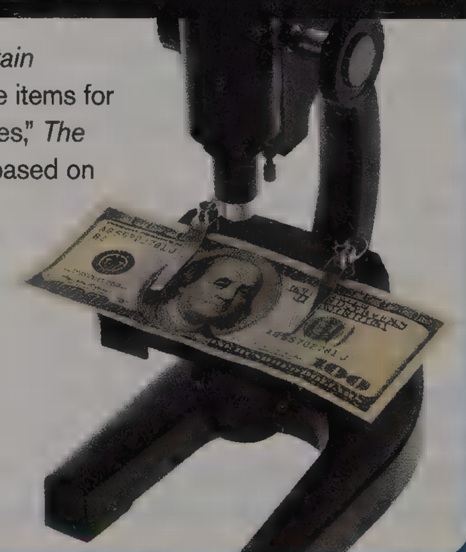
On their gift tax returns for 2004, the couple reported the dollar amounts of the gifts and, based on the appraisal, further described the gifts as interests of 2.39% and 0.101% in the LLC to each child and grandchild, respectively. The LLC's financial records for 2004 showed capital account transfers from the donors to the donees that were greater than the dollar amounts in the gift documents.

The IRS redetermined the value of an LLC member interest unit and, applying the gift percentages, increased the values

2010 Partnership R&D Deductions

Beginning in 2010, partnerships filing Schedule M-3, *Net Income (Loss) Reconciliation for Certain Partnerships* (generally, those with assets of $10 million or more), were required to include these items for research and development costs and deductions. See "Managing New Schedule M-3 Disclosures," *The Tax Adviser*, Dec. 2011, page 818. Dollars amounts are in thousands. All figures are estimates based on random sampling.

	Expense per income statement	Temporary difference	Permanent difference	Deduction per tax return
Amount	$3,795,091	$918,195	$11,352	$4,724,027
Number of returns	370	233	172	515
Average	$10,257	$3,941	$66	$9,173



Source: IRS Statistics of Income, 2010 Partnership Returns Line Item Estimates (Publication 5035), Form 1065, Schedule M-3, *Net Income (Loss) Reconciliation for Certain Partnerships*, Part III, Line 29. Available at **tinyurl.com/9vgfcq8**.

PHOTO BY ISTOCKPHOTO/THINKSTOCK

of the gifts. After negotiations, the parties agreed that the percentage interests given each child and grandchild would yield values of $315,800 and $13,346, respectively. However, the taxpayers continued to argue in a petition to the Tax Court that they had not transferred fixed LLC percentage interests. The IRS contended that the gift tax returns, capital accounts, and the gift documents themselves all supported fixed percentages. It also argued the adjustment clause created a "condition subsequent" to completed gifts and thus was void as contrary to public policy, as courts have held in a line of cases from *Procter*, 142 F.2d 824 (4th Cir. 1944). Such "savings clauses" allow donors or estates to "take property back" in an amount necessary to avoid transfer taxes.

The Tax Court held that despite the gift return's percentages, there was no evidence the donors intended to give more than the fixed dollar amounts, and that the capital accounts were not controlling. The gift documents did not state a number of LLC units transferred, but the number was nonetheless predefined as a mathematical formula of which the only unknown was the LLC's FMV, the court said. This, the court noted, was similar to the holding of the Ninth Circuit in *Estate of Petter*, 653 F.3d 1012 (9th Cir. 2011), aff'g T.C. Memo. 2009-280. In *Petter*, the additional property transferred under a formula clause was transferred to a charity, and the estate claimed a charitable deduction of the amount (see previous Tax Matters coverage Nov. 2011, page 74). The lack of a charitable component in *Wandry* did not raise any "severe and immediate" public policy concern, the Tax Court said. The mechanism to determine the allocation between donors and donees did not operate to take property back and was a valid adjustment, not an impermissible savings clause, the court held.

Following the decision in *Wandry*, the IRS filed an appeal with the Tenth Circuit but in October withdrew it without explanation. In the action on decision, the IRS reiterated its long-held position that "the final determination of value for federal gift tax purposes is an occurrence beyond the taxpayers' control." A gift is complete for federal tax purposes when the donor parts with dominion and control and any power to change its disposition, the IRS said, citing Regs. Sec. 25.2511-2(b). The gifts in *Wandry* were complete on the date of gift as fixed percentage interests, it said. In *Petter*, any adjustment went to a charity, not to the donor, so the court did not have to consider whether the gift was complete, the IRS said. Thus, in *Wandry*, the IRS said, the Tax Court erred in considering the gifts as anything other than fixed percentage interests.

For more, see "Formula Clauses: Adjusting Property Transfers to Eliminate Tax" in the February 2013 issue of *The Tax Adviser* and "New Life for Charitable Lids," *JofA*, Sept. 2010, page 50.

> The lack of a charitable component in *Wandry* did not raise any "severe and immediate" public policy concern, the Tax Court said.

PARTNERSHIPS

NINTH CIRCUIT AGREES FARMING ACTIVITY IS PARTNERSHIP

The Ninth Circuit agreed with the Tax Court that a father-son farming and logging operation was a partnership for federal income tax purposes and that the father's deduction of the bulk of the activity's expenses on his individual return was not acceptable.

William and Randal Holdner operated a farming activity, Holdner Farms. Randal, the son, conducted the farm's day-to-day physical operations, and William, the father, who was also a practicing accountant, was responsible for sales, purchasing, financing, and accounting. Each party reported one-half of the activity's gross income for tax purposes. However, William Holdner allocated the expenses between himself and his son arbitrarily. Most of the expenses he allocated to himself and deducted on his tax return's Schedule F, *Profit or Loss From Farming*, claiming a net loss in each of the years at issue, 2004–2006. Although the Holdners did not file a partnership return for Holdner Farms, upon examination of their individual returns, the IRS determined that Holdner Farms was a partnership in which the Holdners held equal ownership interests and that they must allocate the income and expenses from the partnership accordingly.

The IRS also assessed an accuracy-related penalty against William Holdner for the years under examination because of the improper deductions of Holdner Farms' expenses.

In analyzing the Holdner Farms activity, the Tax Court used the eight-factor test from its opinion in *Luna*, 42 T.C. 1067 (1964), for determining whether an enterprise is a partnership for federal income tax purposes. The court concluded that seven of the eight *Luna* factors supported characterizing the activity as a partnership. The court also determined there was not substantial proof that the Holdners did not hold equal interests in the partnership and therefore the income, expenses, and other partnership items should be allocated equally between them. It also sustained the accuracy-related penalty against William Holdner because, as a practicing accountant with many years' experience, he did not act reasonably in allocating a disproportionate share of Holdner Farms' expenses to himself.

In a short, unpublished opinion, the Ninth Circuit agreed with the Tax Court that Holdner Farms operated as a partnership for the years at issue.

■ *Holdner*, No. 11-71593 (9th Cir. 10/12/12), aff'g T.C. Memo. 2010-175

*By **Alice A. Upshaw**, CPA, MPA, CMA, instructor of accounting, and **Darlene Pulliam**, CPA, Ph.D., Regents Professor and McCray Professor of Business, both of the College of Business, West Texas A&M University, Canyon, Texas.*

GROSS INCOME

COMMENTS SOUGHT ON COD REPORTING

In Notice 2012-65, the IRS asked for public comments on whether it should amend existing Regs. Secs. 1.6050P-1(b)(2)(i)(H) and (iv), which require applicable financial entities to issue Forms 1099-C reporting cancellation of debt (COD) income when a 36-month nonpayment testing period has expired.

Under Sec. 6050P and its regulations, COD income of $600 or more must be reported on Form 1099-C when any of eight identifiable events occur.

Under Sec. 6050P and its regulations, COD income of $600 or more must be reported on Form 1099-C, *Cancellation of Debt*, when any of eight identifiable events occur. Seven of these events are specific instances that actually result in a discharge of debt, such as an agreement between the creditor and debtor. The eighth, the expiration of the nonpayment testing period, does not actually result from a discharge and may be difficult to determine. It may also be confusing to debtors who receive these forms and do not know whether to report the amount in income.

The nonpayment testing period is a 36-month period during which a creditor has not received any payment from the debtor, which creates a presumption that the loan was discharged, thus triggering the Form 1099-C filing requirement. The creditor can rebut this presumption by showing significant, bona fide collection activity or other facts and circumstances that indicate the debt has not been discharged.

The nonpayment testing period was added to the regulations in 1996 in response to creditors' concerns that the prior facts-and-circumstances test for determining when an identifiable event had occurred was not sufficiently clear to allow them to determine when reporting was required. Commenters requested that reporting be required only after a fixed period during which no collection efforts have been made. The result was the 36-month nonpayment testing period.

However, the IRS has determined that, although creditors must file Form 1099-C at the end of the period, it does not mean the debt has necessarily been canceled. This can then cause confusion about whether the recipient of the form must report the amount on the form as COD income.

The IRS is therefore requesting comments on the following issues:

- Whether Regs. Sec. 1.6050P-1(b)(2)(i) should be amended to remove the nonpayment testing period as an identifiable event.
- Whether removing the nonpayment testing period would increase or decrease creditors' and taxpayers' burden.
- If the nonpayment testing period is removed, what rules should be added to address continuing collection activity?
- If the nonpayment testing period is retained, how can it be modified to make it less confusing?

Comments, which must be received by Feb. 11, 2013, can be sent by mail, email, or hand delivery to the addresses listed in the notice.

Tax Matters editor Paul Bonner can be reached at pbonner@aicpa.org or 919-402-4434.

Line Items

NEW ITIN PROCEDURES ISSUED

The IRS eased some of its strict new procedures for obtaining individual taxpayer identification numbers (ITINs) (FS-2012-11), while making other procedures more stringent.

Under interim rules issued in June 2012, the IRS will not issue ITINs unless applicants provide original documents, such as passports or birth certificates, or certified copies of those documents from the issuing agencies (IR-2012-62). Previously, ITINs could be issued based on notarized copies of the required documents. After June 2012, ITINs could not be issued based on applications submitted through certifying acceptance agents (CAAs) unless they attached original documentation or copies of original documents certified by the issuing agency (see previous Tax Matters coverage, Nov. 2012, page 68).

Beginning in 2013, individuals who need ITINs must still supply original documents, such as passports or birth certificates, or certified copies of those documents from the issuing agencies. However, to alleviate concerns over parting with these documents for long periods (and the risk of a document's being misplaced by the IRS), beginning in January 2013, CAAs could once again verify the authenticity of identification documents for ITIN applicants and their spouses and do not need to send original documents to the IRS. But ITIN applications for dependents still must be submitted with original documents. However, by late in January 2013, the IRS said, it would set up Taxpayer Assistance Centers, where dependents' documents can be reviewed so taxpayers do not have to part with originals.

Another of the more stringent new requirements is that new ITINs will be effective for only five years, after which taxpayers have to apply for a new one.

The standards for CAAs were significantly strengthened by allowing only those who are covered under the professional standards of Circular 230—attorneys, CPAs, enrolled agents, and registered tax return preparers—to qualify as CAAs. CAAs are also now required to complete a forensic document identification training course. The CAA application and renewal processes remain unchanged.

TIGTA: MODERNIZED e-FILE IMPROVING

The Treasury Inspector General for Tax Administration (TIGTA) reported that the IRS has improved its Modernized e-File (MeF) system, using it for most returns in 2012, and recommended that it develop a plan for retiring its older Legacy e-File system (TIGTA Rep't No. 2012-20-121). The IRS started to phase out the legacy system in 2004 as it introduced the internet-based MeF system, first for corporate returns and, starting in 2010, for individual returns.

For the 2011 filing season, the IRS received only 8.7 million individual income tax returns through MeF, while in 2012, MeF received 72.4 million individual returns (versus 49.8 million filed on the legacy system). The IRS increased the number of approved software packages for the new system and increased MeF filings by notifying transmitters that had submitted 1 million or more individual returns electronically in the 2011 filing season that they were required to submit their 2012 filing season returns using MeF.

The IRS should develop a plan to completely shut down the legacy system once the risks of doing so can be addressed, TIGTA said. The IRS responded that it had discussed the legacy system's future but had not yet decided to retire it.

In a related development, the IRS told the Electronic Tax Administration Advisory Committee in December that MeF will be the only electronic system available to software developers, transmitters, and states for the 2013 filing season. The legacy system will remain available for the 2013 season in case of delays in MeF or related systems, the IRS said.

STANDARD MILEAGE RATES UP A PENNY IN 2013

Optional standard mileage rates for use of a vehicle went up by 1 cent per mile for 2013, the IRS announced in Notice 2012-72.

For business use of a car, van, pickup truck, or panel truck, the 2013 rate is 56.5 cents per mile. Driving for medical or moving purposes may be deducted at 24 cents per mile. Both rates are 1 cent higher than for 2012.

The rate for service to a charitable organization is unchanged, set by statute (Sec. 170(i)) at 14 cents a mile.

The portion of the business standard mileage rate that is treated as depreciation is 23 cents per mile for 2013, unchanged from 2012.

For purposes of computing the allowance under a fixed and variable rate (FAVR) plan, the maximum standard automobile cost for 2013 is $28,100 for automobiles (not including trucks and vans) or $29,900 for trucks and vans, increases of $100 and $600, respectively, from 2012. Under a FAVR plan, a standard amount is deemed substantiated for an employer's reimbursement to employees for expenses they incur in driving their vehicle in performing services as an employee for the employer. ❖

GAINS & LOSSES

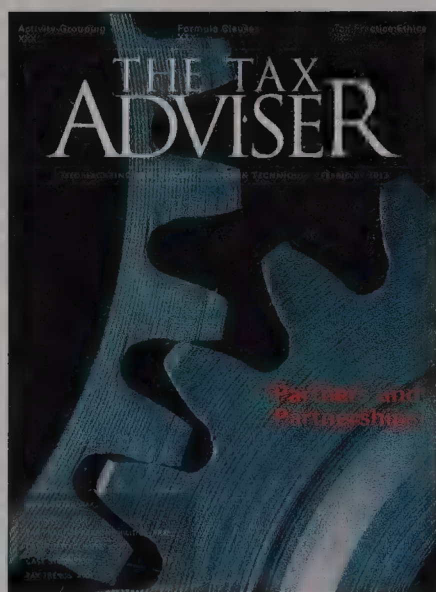
Grouping Passive Activities

One technique for converting otherwise passive activities to nonpassive is grouping them and treating them collectively as a single activity, thereby combining the participation hours and improving a taxpayer's ability to achieve the necessary hours for material participation. Regs. Sec. 1.469-4 provides general rules and limitations for grouping activities and applies a facts-and-circumstances test to determine the appropriateness of a particular grouping. In general, activities can be grouped for purposes of Sec. 469 if they constitute an appropriate economic unit for measuring gain or loss.

BENEFITS AND DRAWBACKS

Grouping activities allows taxpayers to treat them as one when applying the tests to determine material participation. For example, a chef who owns two restaurants can treat them as a single activity, and if he spends 500 hours working in one of them during the year and none at the other, he will still pass the first test of the seven material participation tests under Temp. Regs. Sec. 1.469-5T(a) to be considered nonpassive. Since such a move likely forms an appropriate economic unit due to common ownership and similarity in business, he can add his catering company to this group as well. If the catering company produced a loss for the year and the chef did not materially participate in it, the passive loss may be suspended to a future tax year absent any passive income to offset it against in the current year. Grouping the catering company with the restaurants as a single activity and thereby treating it as nonpassive will allow the chef to realize the tax benefit of the loss currently.

However, once a taxpayer chooses a grouping, it must remain in effect for all future tax years. This may affect the taxpayer's ability to use suspended losses in future tax years. When a passive activity is disposed of, its suspended losses are freed up to first offset any gain on the disposition, with the excess losses then treated as nonpassive and available to offset any other taxable income, including portfolio and earned income. But once the chef includes the catering company in the grouping with the restaurants, to entirely dispose of the activity requires disposing of the two restaurants and the catering company. Merely selling or abandoning the catering company will not constitute disposing of all or significantly all of the activity anymore.



thetaxadviser.com

Clearly, the existence of suspended losses should be considered when deciding whether to group certain activities into one. Another important consideration is the type of income and loss the taxpayer expects from other activities. If the chef owns another business that is a passive activity that typically generates losses, and the catering company is expected to produce income, the chef would do better tax-wise to leave the catering company as a separate activity without material participation.

For a detailed discussion of the issues in this area, see "Activity Grouping: The Impact of Recent Developments," by Daniel Rowe, CPA, in the February 2013 issue of *The Tax Adviser*.

—Alistair M. Nevius, editor-in-chief
The Tax Adviser

Also look for articles on the following topics in the February 2013 issue of *The Tax Adviser*:

- A look at recent developments affecting partnerships.
- An analysis of formula clauses in wills and gifts.
- A discussion of establishing an ethical culture in a tax practice.

The Tax Adviser is the AICPA's monthly journal of tax planning, trends, and techniques. AICPA members can subscribe to *The Tax Adviser* for a discounted price of $85 per year. Tax Section members can subscribe for a discounted price of $30 per year. Call 800-513-3037 or email taxsection@aicpa.org for a subscription to the magazine or to become a member of the Tax Section.

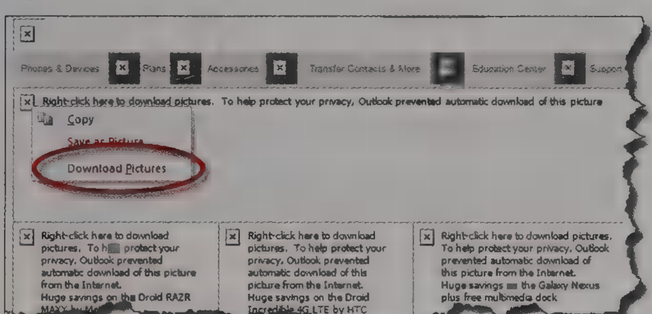
Technology Q&A

by J. Carlton Collins, CPA

AUTO-TRUST EMAILED IMAGES

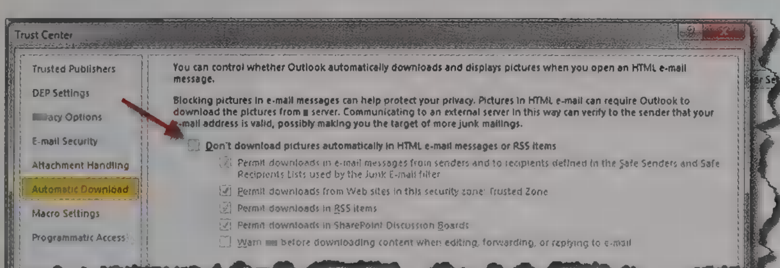
Q When I open email containing pictures or images, Outlook 2010 does not automatically display those images unless I right-click on the image and select **Download Pictures**. Why does Outlook 2010 do this, and is there a way to automatically display images when opening my email?

A As a security measure, Outlook 2010 blocks images/pictures in your HTML-formatted email by default and leaves it up to the user to determine whether it is safe (or necessary) to download and display the images. Outlook does this to prevent inappropriate pictures from being displayed, to prevent running malicious code that might be triggered upon opening an image, and to increase email retrieval speed for users with low-bandwidth internet. In addition, the process of displaying an emailed image confirms for spammers that they have reached a valid and active email address, which might trigger more spam. As you mentioned, you can view the blocked images by right-clicking on the blocked image and selecting **Download Pictures** from the pop-up menu, as pictured below.

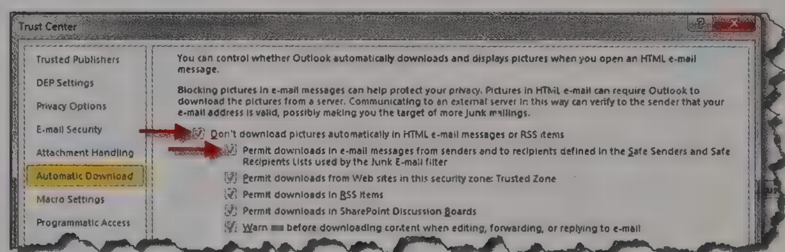


If you are comfortable opening your emailed images automatically, you have two options. You can either automatically accept images from all senders, or you can automatically accept images from selected senders, as follows.

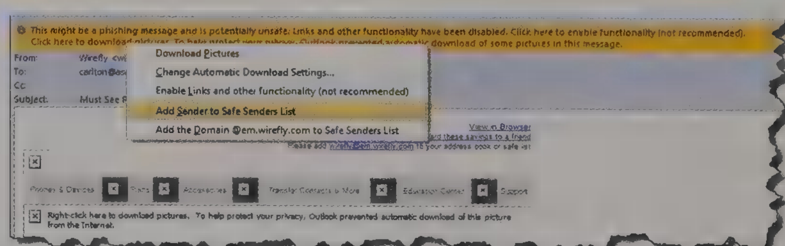
To automatically accept images from all senders, from the Outlook 2010 **File** tab, select **Options**, **Trust Center**, and click the **Trust Center Settings** button. In the **Trust Center** dialog box, select **Automatic Download** and uncheck the box labeled **Don't download pictures automatically in HTML e-mail messages or RSS items** (shown at bottom left). This setting will allow all of your email images to display automatically.



As an alternative, you could add selected senders to your Safe Senders List. After that, their email images would open automatically, but images from nontrusted sources would remain blocked until you decide to view them. To use this method, from the Outlook 2010 **File** tab, select **Options**, **Trust Center**, and click the **Trust Center Settings** button. In the **Trust Center** dialog box, select **Automatic Download** and place checkmarks in the boxes labeled **Don't download pictures automatically in HTML e-mail messages or RSS items** and **Permit downloads in e-mail messages from senders…** (as pictured below).



Next, each time you receive an email from a sender whose images you trust, right-click on the warning message (shown at the top of the screen in the screenshot below) and select **Add Sender to Safe Senders List**.



These settings will enable emailed images from trusted sources to display automatically. *Note:* If you do not see the warning message at the top of your email, as pictured above, you can display this warning message by navigating to the Trust Center dialog box as described above, then check the box labeled **Warn me before downloading content when editing, forwarding, or replying to e-mail**.

DO I KNOW YOU?

Q All of a sudden I am unable to invite my friends to connect with me on LinkedIn unless I supply their email addresses. Yet my colleague is able to invite these same friends without supplying an email address. Can you explain what's going on and tell me how to resolve this issue? Thank you.

A LinkedIn's official policy is to flag your account and lock down your invitations when five people reject your invitations using the IDK (I don't know) flag. LinkedIn imposes this restriction on its users to reduce spamming. When this happens, LinkedIn sends you an InMail message notifying you that your account has been restricted, and you must supply the invitee's correct email address to send future invitations. Further, if you continue to receive IDK flags, it can result in suspension of all invite privileges and, eventually, your entire LinkedIn account.

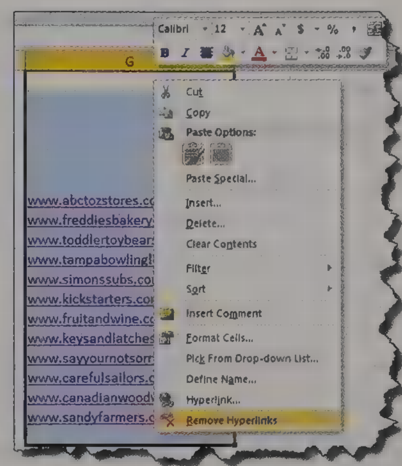
To determine if you have been IDK flagged and to see who flagged you, select **Inbox** from the LinkedIn main menu. Next, select **Sent** (under the **Compose Message** button) and click the **Sent Invitations** tab to display a listing of your prior invitations. The words **Doesn't know** will appear next to those invitations that were rejected by your invitee using the IDK flag.

To rectify this problem, you can email LinkedIn's customer support personnel at cs@linkedin.com. Be sure to send your request using the email address associated with your LinkedIn account, include your contact information, assure LinkedIn that you will not abuse invitations in the future, and ask customer support to remove the restrictions for sending invitations.

REMOVING HYPERLINKS IN EXCEL

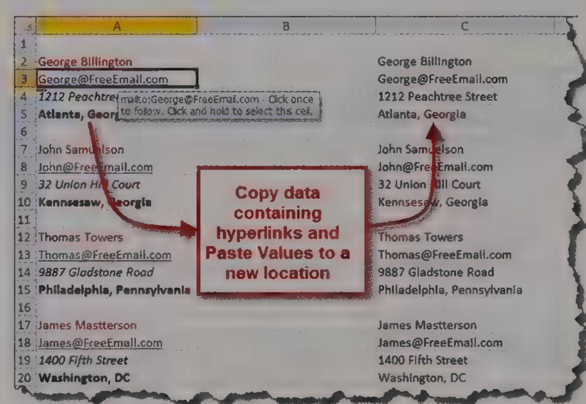
Q I frequently copy and paste large amounts of data from the web into Excel 2010. My problem is the pasted data often contains hundreds of hyperlinks, which makes it difficult to then select those cells without triggering the hyperlinks (to avoid triggering a hyperlink, I click on a nearby cell and then arrow over to the cell containing the hyperlink). I know I can avoid this problem by pasting the data into Excel using the **Paste Values** command, but I don't want to lose the webpage formatting, so this approach doesn't work for me. I have tried copying the hyperlinked cells and pasting them as values [to the same location], but the hyperlinks still remain, so this doesn't work either. My current approach is to right-click on each cell and select **Remove Hyperlink** one at a time. Is there an easier way to remove these hyperlinks?

A Excel 2010 provides a new option called **Remove Hyperlinks** (plural—with an "s") that enables you to remove multiple hyperlinks (prior editions of Excel provide only the **Remove Hyperlink** option, which removes only one hyperlink at a time). To remove more than one hyperlink, select a range containing multiple hyperlinks (such as a range of cells, columns, rows, or an entire worksheet), then right-click on any cell, and select **Remove Hyperlinks** from the pop-up menu. (The **Remove Hyperlinks** tool does not work across multiple worksheets.)

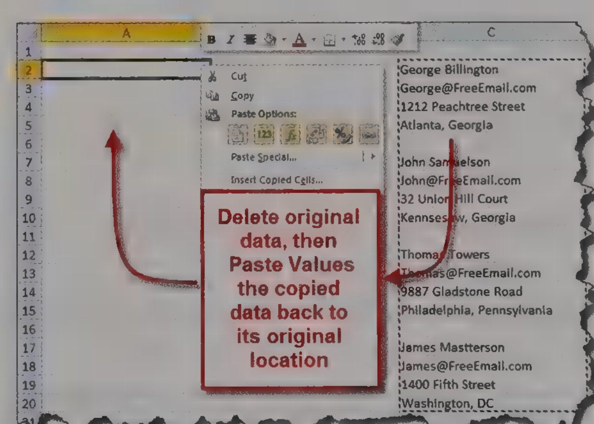


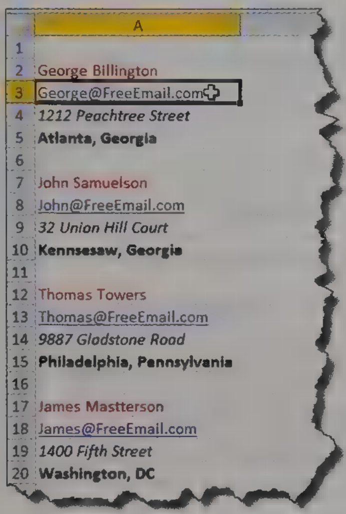
Note: **Remove Hyperlinks** appears when your selection range contains two or more hyperlinks, otherwise **Remove Hyperlink** appears, which is probably why you previously overlooked this option.

For those using Excel 2007 or 2003, here is a trick that might help. You can remove multiple hyperlinks but retain the formatting by copying a range of data containing multiple hyperlinks and pasting them to a new location using the **Paste Values** command (from column A to column C in the example pictured below).



Next, delete the original data you copied. This action will delete the data and the hyperlinks, but not the formatting. Finally, **Copy** the data and **Paste Values** that data again to its original location (from column C back to column A in the example pictured below). (Remember, when using **Paste Values**, the pasted data adopts the formatting of the paste destination.)





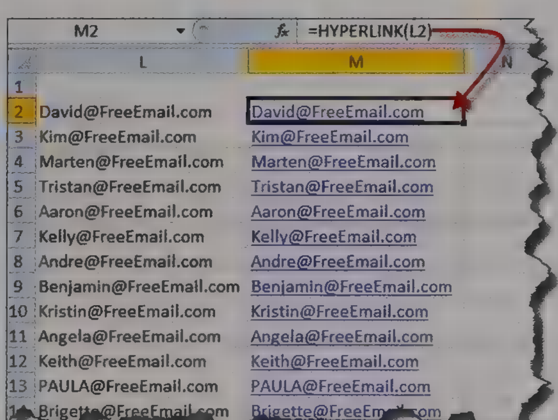
The data will be returned to the original location, with formatting, but no hyperlinks, as shown at left. (Notice in the picture at left that when the cursor hovers over the data in cell A3, which previously contained a hyperlink, no hyperlink pops up.)

One final tip: You can select a cell containing a hyperlink using your mouse by clicking on the cell and holding the mouse button down a few seconds until the pointer becomes a cross shape, and then releasing the mouse button.

CREATING HYPERLINKS IN EXCEL

Q My accounting software enables me to export my customer data to Excel, but the customers' email addresses do not show up as clickable hyperlinks. I must edit each email address one at a time to delete the leading apostrophe to convert the text-based email address to clickable email addresses. Is there an easier way to do this?

A Excel 2010, 2007, and 2003 provide a hyperlink function that converts text to a clickable hyperlink. In the example below, I entered =HYPERLINK(L2) in cell M2, which converts the text-based data in cell L2 into a clickable hyperlink. I then copied this formula (in cell M2) down to convert the other text-based email addresses to clickable email addresses.

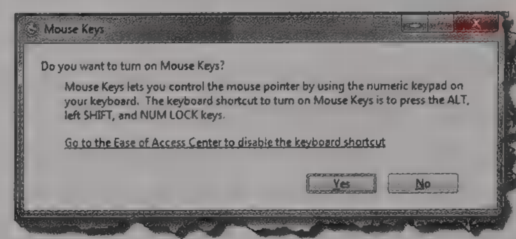


Caution: Using the **Copy, Paste Values** commands to convert the =HYPERLINK formula to regular text removes the hyperlink.

NO COFFEE FOR MY MOUSE, PLEASE

Q I spilled coffee on my mouse, and it stopped working. I then was unable to operate certain software on my Windows computer that requires mouse movements until I purchased a replacement mouse. I am curious to know if there is a way to perform mouse movements in Windows without actually having a mouse.

A Windows provides a mouse alternative called Mouse Keys. To activate Mouse Keys, simultaneously press the Left Alt+Left Shift+NumLock keys. Thereafter, toggling your NumLock key on will allow you to control the mouse pointer using your numeric keypad's arrow keys.



DUST IN THE WIND

Q I heard on the news last week that it is important to clean the inside of your computer regularly, but I've never done this before. Is this true, and if so, how do you clean the inside of a computer without causing damage?

A Ordinarily I would not address a question like this, but your question prompted me to check my computer, and it was sorely in need of a good scrubbing. Thanks for the reminder.

The amount of cleaning your computer needs depends on the cleanliness of your computer's environment. At a minimum you should check your computer's fan intake regularly to see if it needs cleaning. Dust on a computer fan grill can impede airflow enough to overheat and damage the motherboard or other components. A large amount of dust on the fan grill also might indicate a dust buildup inside of the computer.

Manufacturers typically design desktop computers so you can easily remove the cover to inspect, clean, and maintain the internal workings, as follows.

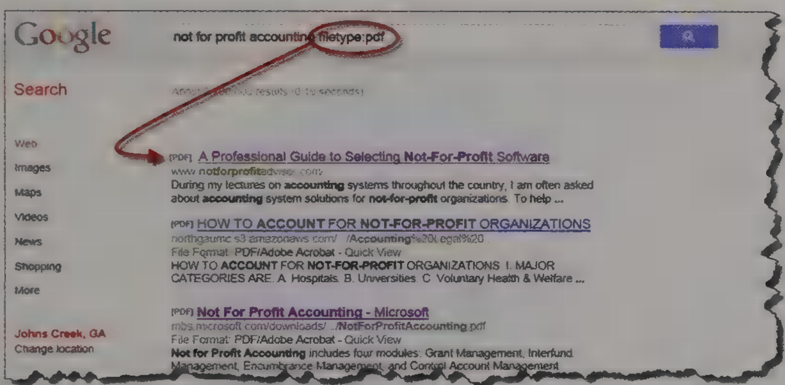
1. Turn off the computer.
2. Unplug the electrical cord and other USB devices and cables.
3. Ground yourself by touching something metal, such as a filing cabinet (to eliminate any static electricity that might exist in your body or clothing).
4. Remove the computer's cover.
5. Clean inside the computer gently, as follows:
   a. Use a can of compressed air (available at most office supply stores for about $5 to $10) to blow dust off of the circuit boards. Be sure to blow the dust away from the circuit boards and out of the computer case.
   b. Office supply stores typically sell small computer vacuum cleaners (priced from $35 to $300) with special attachments designed specifically for cleaning the inside of a computer. Use the soft brush vacuum hose to gently remove dust buildup from the circuit boards.
   c. Use a cotton swab dampened in alcohol to remove dust from hard-to-reach corners and crevices. Use a tissue dampened with alcohol to clean plastic and surfaces such as the fan blades or inside walls of the case.
6. Consider documenting the date and the amount of dust

encountered on a note taped to the side of the computer to help you judge the necessity/frequency of future cleanings. (Some of your computers may need cleaning more frequently than others, depending upon their immediate environment.)

SEARCHING FOR ACROBATS

Q While looking for a PDF file on the web, I tried including pdf, .pdf, and ".pdf" in my search criteria, but I still found mostly websites instead of PDF documents. Is there a way to search the web for PDF documents only?

A When searching the web using Bing or Google, you can search specifically for PDF files only by including the phrase filetype:pdf in the search criteria.



When using Yahoo!, include the phrase originurlextension:pdf in your search criteria.

Note: You can also search for Excel, Word, or PowerPoint files in the same manner by substituting xlsx, docx, or pptx for pdf in the above search phrases. (The suffix pdf refers to Adobe Acrobat's Portable Document Format, while xlsx, docx, and pptx refer to Microsoft's latest Excel, Word, and PowerPoint 2010/2007 file formats, respectively.) ❖

J. Carlton Collins (carlton@asaresearch.com) is a technology and accounting systems consultant and a JofA contributing editor.

Note: *Instructions for Microsoft Office in "Technology Q&A" refer to the 2007 and 2010 versions, unless otherwise specified.*

Submit a question

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to jofatech@aicpa.org. We regret being unable to individually answer all submitted questions.

Inside AICPA

EINHORN RECEIVES INSTITUTE'S HIGHEST AWARD FOR TAX

Alan R. Einhorn, CPA, received the 2012 Arthur J. Dixon Memorial Award, the highest award given by the accounting profession in the area of taxation.

Alan Einhorn (left) and Edward Karl

The annual award, given by the AICPA Tax Division, honors Arthur J. Dixon, a CPA known for his outstanding record of service to the tax profession and the AICPA Tax Division. The award was presented at the division's fall meeting in Washington by Edward S. Karl, CPA, vice president–Taxation for the AICPA.

Einhorn is the chief quality officer for Deloitte Tax LLP and works in many areas including ethics and professional standards, taxpayer and preparer responsibilities, and tax quality assurance. He also frequently represents the firm in regulatory and legislative tax matters.

Einhorn is the vice chairman of the board for Deloitte Tax LLP and is a member of the firm's operating committee.

In his 25 years of volunteer service for the AICPA, he has chaired the AICPA Tax Forms Committee, Circular 230 Education Task Force, Preparer Penalty Task Force, and the Tax Executive Committee, and has served as a member of several other task forces and committees. He currently chairs the Relations with the Bar Committee.

FORMER AICPA CHAIRWOMAN NAMED DEPUTY PRESIDENT OF IFAC BOARD

Olivia Kirtley, CPA, CGMA, a member of the AICPA governing Council and former chairwoman of the Institute's board of directors, was named deputy president of the International Federation of Accountants (IFAC), a global organization dedicated to strengthening the accounting profession.

Kirtley is the first woman to be elected IFAC's deputy president. She succeeds Warren Allen, who was appointed IFAC president, and she will serve a two-year term.

Kirtley became a member of the IFAC board in 2007, following a stint on the independent IFAC Task Force on Rebuilding Public Confidence in Financial Reporting from 2002 to 2003.

As deputy president of the board, Kirtley, a business consultant on strategic and corporate governance issues, will chair IFAC's planning and finance committee, which works directly with IFAC staff to develop the organization's strategic plan. She also heads the board's constitution review working group and serves on the nominating committee and the regulatory liaison group.

"Olivia's election as IFAC's deputy president is important for the business community and the profession," AICPA President and CEO Barry Melancon said in an AICPA news release. "Her perspective as former chairman of the AICPA, a former CFO, and presently as board member of several companies makes her uniquely qualified for this critical international leadership role for the profession."

In 1998, Kirtley became the first woman to be elected to chair the AICPA board of directors. From 2000 to 2003, she

headed the AICPA Board of Examiners, which oversees the content and structure of the uniform CPA examination. During her tenure, the board of examiners converted the CPA exam from a pencil-and-paper format to a digital format. In 2003, the AICPA awarded her the Gold Medal for exemplary leadership and service to the accountancy profession.

JofA IPAD APP RECOGNIZED FOR EDITORIAL EXCELLENCE

The Journal of Accountancy News App for iPad was a winner in *Folio:* magazine's 2012 Eddie & Ozzie Awards, the largest competition in magazine publishing. The *JofA*'s app, which launched in June 2012, received a silver Eddie award, which recognizes editorial excellence, in the Best App, B-to-B category.

The app features news from the *JofA*, AICPA feeds, and *CPA Letter Daily*; the latest issue of the *JofA*; videos; an article search function; and a library to store and easily download past issues. The app was developed by the *JofA* and CPA2Biz Inc., the technology subsidiary of the AICPA.

The app is free and available only to AICPA members. To find out more and download the app, visit journalofaccountancy.com/Web/iPad.htm.

ORGANIZATIONS FIGHTING U.S. DEBT GET SUPPORT OF AICPA BOARD

A continuing devotion to fiscal responsibility has led to a resolution by the AICPA board of directors supporting two nonpartisan organizations devoted to combating the U.S. federal debt.

In the resolution, the AICPA expresses support for the Campaign to Fix the Debt and the Comeback America Initiative, which express concern over the federal debt's impact on the nation's long-term fiscal health. The resolution is available at tinyurl.com/d2rbsqz.

The AICPA, which believes the U.S. government should operate on a sustainable budget and address its current debt crisis, will encourage state CPA societies to consider getting involved in the efforts and promoting fiscal responsibility, according to the resolution, which the board adopted on Nov. 9.

In addition, the resolution says, the AICPA will continue to seek ways to advocate for reduced complexity for American businesses and individuals.

The resolution reinforces a message the AICPA already has been sending. Greg Anton, the 2011–12 chairman of the AICPA board of directors, described the debt the United States has accumulated and the consequences it could have for the future of the nation in a video, "What's at Stake," which is available at tinyurl.com/b4hmave. ❖

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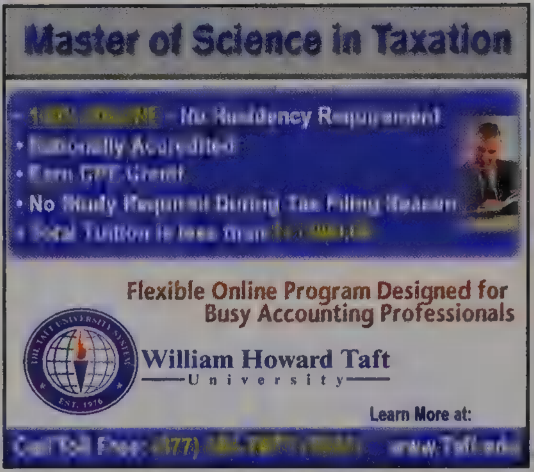

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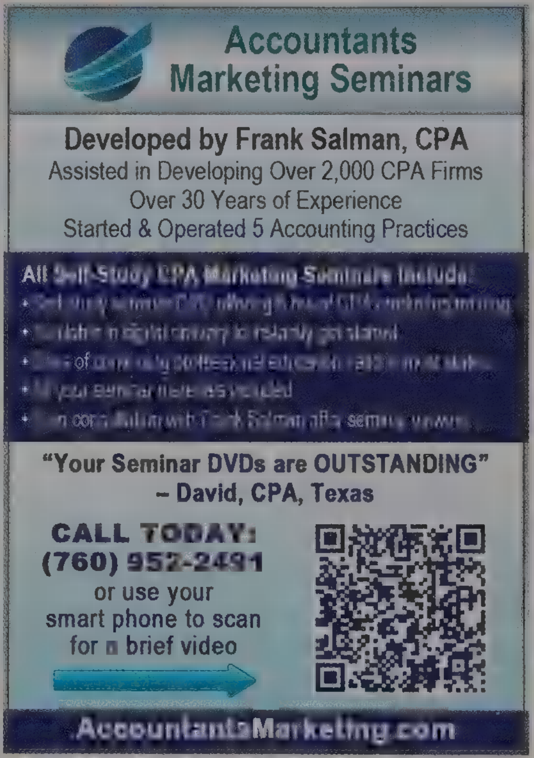

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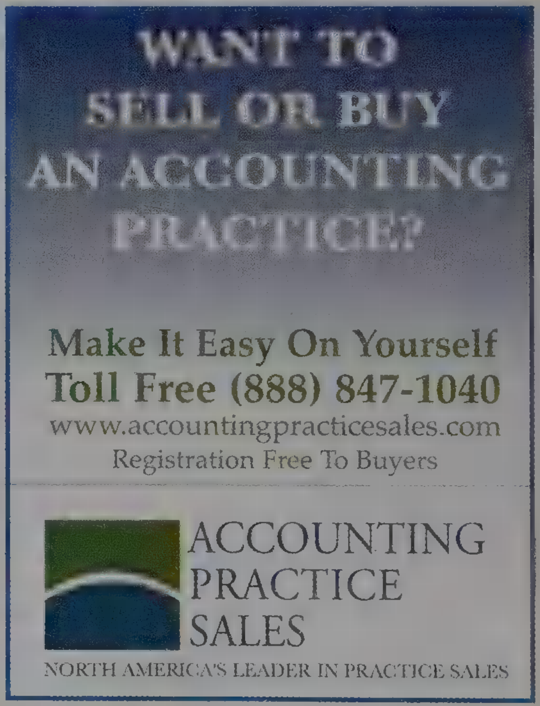

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THE LAST WORD

When I was little, and other kids would read storybooks and my mom wanted to buy us storybooks, I begged and pleaded with her because I wanted math workbooks. My mother, who is an avid reader, just did not understand it, until I cried and cried and said, "I really want math workbooks." That was my summer reading. Even though I did read storybooks, I loved doing math workbooks. I always felt math was logical, because there was a definite answer to the problem.

In my junior year of high school, I was going to be a fashion designer. I applied to Fashion Institute of Technology in New York, and I was pretty much set that that's what I wanted to do. I enjoyed clothes, especially creating my own clothing. Then, as a senior, I started taking business classes; when I took accounting, I fell in love with it. I found out I had such a passion and such a talent for it that I changed my career choice.

When I took the CPA exam, we were not allowed calculators, and it was not computerized. That was really hard because we had to take all four parts within prescribed time limits. Even though I enjoyed doing manual calculations, I felt that speed under pressure could affect accuracy. I remember those days when financial statements were done on green sheets and we sat there with pencils and added everything up. Now, we have technology that is just fascinating.

Joanne Newfield, CPA, CGMA
Director of Accounting,
Chester Community Charter School
Chester, Pa.

Accounting to me is kind of like being a detective. You're finding mistakes, ensuring that supporting schedules tie out, reconciling accounts. I feel like I'm the FBI agent of the books. I look at the numbers that way, and I try to find the fun in it. That's what the passion is all about. If somebody doesn't have a passion for what they do, then it's a chore, and it shouldn't be. We should do what we like.

I find working for a nonprofit school really rewarding. The success of our children depends on a good educational system. The next generation, they have to step up and act like they're leaders. I tell colleagues: "They're not students; they're leaders who need to be built up, motivated, and challenged." It feels good that we're contributing to the success of our nation and our economy for the future.

I started teaching fitness classes when my daughter was 2 years old. I went back to the gym with 40 extra pounds and ripped zippers on every pair of jeans I owned, from trying to squeeze into them. I started a diet and exercise program and lost the weight in three months. When the manager of the club needed a class filled, she offered to train me to teach the class. The first time I taught, I was petrified. I taught a 40-minute class in 20 minutes. The students looked up and thought, "OK, now what." I always said when it stops being fun, I will quit; that was 23 years ago.

To me, teaching classes is just exhilarating. It's so much fun being on stage. It's like it's my alter ego, when I'm up there animated and motivating others. It's such an ego boost, having people come up and say, "Hey, great class."

I teach a cycling class on Friday night, and right next to the gym is a movie theater. My favorite indulgence is teaching on a Friday night and then splurging at the movies with a bucket of popcorn. My husband and I go every Friday night. Going to movies—that's kind of our thing.

When you're teaching the classes, it's really all about the numbers. The music is in eights, and the choreography has to be balanced in eights and 32s. That's very similar to accounting, where everything has to be balanced; otherwise your scale is tipped. If you're teaching exercise, your students are confused if you're off the beat. If you're doing a balance sheet, your users are confused if the numbers are off.

Teaching exercise has made me a much better speaker and presenter. When I speak in front of people or present financial statements, I can simplify instructions so anyone can understand. If I can't simply break down the choreography, my class is just all over the place; people get upset and leave.

—As told to Neil Amato, namato@aicpa.org, a JofA senior editor.

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